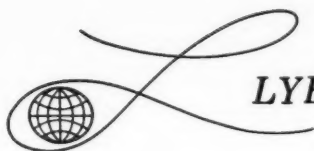




BY BRAND JOURN





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WILLIAM M. LYBRAND

WILLIAM MITCHELL LYBRAND

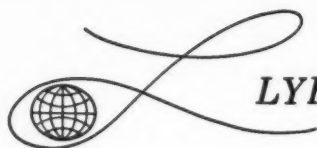
In writing this tribute to our beloved partner, my recollection goes back over a period of seventy-three years. On December 29, 1887, William entered the employ of John Heins, a prominent public accountant of that era. I had the good fortune to be a member of Mr. Heins' staff at that time, and thus began a happy fellowship with William, which has lasted, unbroken, through the years.

William early displayed his ability to meet the demands of his new position, and his employer soon expressed his appreciation of the way in which his exacting assignments were met. He had high ideals and was devoted to his chosen profession. He thus laid a sound foundation for his later accomplishments in accountancy. We who have been his associates are deeply in his debt.

His efforts for the advancement of the accountancy profession were outstanding. Many educational efforts in this connection had his support. In fact, he was a good citizen in every respect. He found time in a very busy life for participation in activities for the furtherance of good civic conditions and the support of the work of the Churches. An illustration of his Church interests was the furnishing of a room in St. George's Methodist Church in Philadelphia, the oldest Methodist Church in continuous operation. Both his grandfather and his father had been pastors of this Church. This was by no means a rare example of his benefactions in Philadelphia and wherever else he resided.

William M. Lybrand will long be remembered as a man of the highest character by those who knew him. We who were so long closely associated with him have been most fortunate in having had such a man for a friend and companion.

T. EDWARD ROSS



William M. Lybrand—In Memoriam

Character is the most important attribute an accountant can possess. After that might come ability and personality, but character stands first.—WILLIAM M. LYBRAND, 1867–1960.

William M. Lybrand, one of the four founding partners of the Firm, was a pioneer of professional accountancy in America. In his 93 years he saw vast changes in the nature and importance of the accountant's function, and during over a half-century of professional activity, played a vital role in the development of the profession as it met the demands of an enormously expanding industrial economy.

Mr. Lybrand was born on August 14, 1867, in Philadelphia, where his family had lived for several generations. Both his father and grandfather were Methodist clergymen, and since the Methodist Church limited the services of its ministers in any one parish to three years, the family was often required to resettle. Recalling these early years and frequent moves, Mr. Lybrand once wrote that while this arrangement was undoubtedly a hardship for the older members of the family, the children always enjoyed moving, for "there was always the chance that it might be a nicer place in which to live, a real bedroom for the youngsters instead of an attic, a new horse to pull the old buggy, less lengthy sermons from the pastor-father . . . Immediately after our arrival at the new appointment, how we scurried up into the attic, out into the barn and everywhere else to see if anything of interest had unwittingly been left behind by the last pastor or his family!"

Mr. Lybrand's formal education ended in 1884 after two years of high school in Philadelphia, although he attended night school for a time studying engineering and drawing, while working in the office of a machine tool building concern as cost accounting clerk, and as assistant bookkeeper. In 1887 he entered the office of John Heins, where Adam and T. Edward Ross were already employed.

PERSONAL RECOLLECTIONS

In writing the history of the Firm for early issues of this JOURNAL, Mr. Lybrand recalled that in 1887 few people in the United States knew what the term "public accountant" really meant, and assumed that it referred to an "expert bookkeeper." An example of the public attitude toward the profession at the time, he recalls, was that "the presence of outside auditors at an establishment might give rise to gossip as to its financial condition. The audit of a bank would be made as secretly as possible. Other work would be done away from the public eye—in private rooms or after business hours. I still recall that in some early assignments, the members of the staff assigned to the work were told to enter the building separately at different times rather than in a body."

At that time there were only a few men in Philadelphia who could rightfully call themselves public accountants; of them, John Heins was unquestionably the leader. In those days there were no regular schools of accountancy, and literature on the subject was scarce and inadequate. A would-be accountant had to learn by doing. The office of John Heins was virtually a training school, and not an easy one, for Heins was an uncompromising perfectionist, and his assistants lived in dread of his well-known explosions of temper at substandard performance. Of his early days there, Mr. Lybrand recalls, "When Mr. Heins looked at your work and commented on it in his caustic way you either wilted or got very angry. It was much safer to wilt. But with it all he really was not unkind—his discipline was good for us. The responsibility we had to assume helped to develop us, and before many years—only four years in fact—I became a junior partner."

On January 1, 1898, Mr. Lybrand joined with the Ross brothers and Robert H. Montgomery—all members of Heins' firm—to form the partnership of Lybrand, Ross Bros. & Montgomery. They took offices, consisting of two rooms, in the Stephen Girard Building on Twelfth Street in Philadelphia. In one room, a single roll-top desk served for all four partners; in the other, one high-standing desk served for a staff of three.* By 1901, the staff had increased to seven, and in 1902, Robert Montgomery opened the New York office, a move which marked the beginning of the

*ED. NOTE—As this issue goes to press the Firm lists 25 domestic offices; total personnel in the organization: over 1,700, including 133 partners.

LYBRAND JOURNAL

establishment of the Firm on a nationwide basis. In 1908, Mr. Lybrand moved to New York as resident partner, remaining there for the rest of his career.

THE GROWTH OF THE PROFESSION

After the death of Mr. Lybrand was announced in the nation's press, a veritable flood of correspondence reached the Firm—from clients, friends, colleagues, and organizations—professional and other—which he had served so long. As one of his professional associates wrote, "Reading of the accomplishments of Bill is rather like reading a history of the profession."

Actually, this estimate is not too far off the mark since Mr. Lybrand was deeply engaged in many facets of the profession's development from its earliest days.

Mr. Lybrand was a charter member of the Pennsylvania Institute of Certified Public Accountants, serving as its first treasurer, and in 1902 he was elected president, holding this office for two terms. During his presidency the Institute established an evening course in accountancy, held in the Philadelphia offices of L.R.B. & M. Lectures were given in four subjects, with Mr. Lybrand delivering those on Practical Accounting. In 1904 the course was taken over by the University of Pennsylvania, and from this modest beginning (the original class had a total membership of 19) developed the Wharton School of Finance.

The first magazine in the field of public accountancy to appear in this country was *The Public Accountant* which was published in Philadelphia in 1898 under the supervision of the Executive Committee of the Pennsylvania Association of Public Accountants, and Mr. Lybrand served as the first secretary of the publishing corporation. This periodical was superseded in 1905 by the *Journal of Accountancy*, to which Mr. Lybrand was among the earliest contributors. His article on "Municipal Accounting in the City of Philadelphia" in the August 1906 issue of the *Journal* was one of the first articles to advocate the adoption by governments of accounting systems similar to those used by business firms.

He was also active in the American Institute for over a quarter of a century, serving on its governing body, as well as on a number of major committees including the historic Committee on Cooperation with the Stock Exchange, whose work aided in post-depression reforms now embodied in the administration of the SEC.

William M. Lybrand—In Memoriam

Among Mr. Lybrand's other contributions to the profession was his support of legislation designed to establish CPA certification. He received Pennsylvania Certificate No. 14 in 1899, and later received certificates in New York and eight other states.

He was an organizer of the National Association of Cost Accountants, formed in 1919, and its president from 1920 to 1922. A memorial resolution by the Board of Directors of N.A.A. as well as resolutions adopted by Council of the Pennsylvania Institute and its Philadelphia Chapter, appear on the following pages.

In 1904, Mr. Lybrand participated in the first International Congress of Accountants at the World's Fair in St. Louis. Members were present from 16 states in the United States as well as from England, Holland, and Canada.

Mr. Lybrand was widely traveled, and the reminiscences of his trips which he wrote for this publication show clearly the "ability to get pleasure out of the ordinary every-day incidents of life," described by a colleague as one of his outstanding qualities. There were many more, but none of more significance than his view of character quoted at the beginning of this account. His life was the embodiment of the French philosopher's dictum: Character is Destiny.

WILLIAM M. LYBRAND

1867-1960

The Board of Directors of the National Association of Accountants records with deep regret the passing on November 20, 1960 of William M. Lybrand, a charter member of the Association and its second national president.

From the founding of the Association in 1919 until 1944, Mr. Lybrand played an active and important role in the development of the organization. As a national officer, director and member of important committees, he contributed materially to the development of N.A.A. and its foundation as an important organization devoted to the advancement of industrial accounting. With constant concern for the improvement and extension of good practice in this field, he gave unstintingly of his energies to expand the Association in its endeavors to enlarge its membership and to bring the benefits of its services to the accountants of the world.

In 1949 the partners of Lybrand, Ross Bros. & Montgomery established as a recognition of Mr. Lybrand's interest in management accounting the present Lybrand medal competition which recognizes meritorious manuscripts on industrial accounting prepared by members of the Association. Since that time the designation of members of N.A.A. as winners of the Lybrand gold and silver medals has had a most encouraging effect on the efforts of members to create manuscripts dealing with important developments in the accounting field.

All who knew William M. Lybrand were charmed by his friendly interest in individuals. He had a warm human touch which was extended to everyone he met. He left a deep imprint on a wide circle of friends and associates. Through his passing the field of accounting has lost a devoted pioneer who continually sought to develop increasing methods for accountants to extend their influence in giving constructive help to business management.

The Board of Directors of the National Association of Accountants extends its deep sympathy to members of the family and associates.

William M. Lybrand—In Memoriam

*Resolution of the Council of the
Pennsylvania Institute of Certified Public Accountants
In Recognition of the Services of William M. Lybrand*

WHEREAS, William M. Lybrand, a charter member of the Pennsylvania Institute of Certified Public Accountants, had maintained his membership in this Institute since its founding in 1897; and

WHEREAS, he rendered outstanding services to the accounting profession in this Commonwealth and throughout the United States, including enlisting support which led to the passage in 1898 of the Pennsylvania law establishing the CPA degree, and serving from 1902 to 1904 as president of the Pennsylvania Institute of Certified Public Accountants and taking an active part in the organization in 1919 of the National Association of Accountants and serving as its president from 1920 to 1922; and

WHEREAS, on November 19, 1960 he departed this life at the age of 93 years,

NOW, THEREFORE, BE IT RESOLVED, That the members of Council desire to express their great appreciation of his character and their feeling of gratitude for his many contributions to the accounting profession during his long and useful life; and

BE IT FURTHER RESOLVED, That a copy of this resolution be spread on the minutes of this Council meeting, and that a copy of this resolution be sent to his surviving nephew, William T. Lybrand, and to the firm of Lybrand, Ross Bros. & Montgomery of which William M. Lybrand was so long a distinguished partner.

*Resolution of the Philadelphia Chapter of the
Pennsylvania Institute of Certified Public Accountants*

WHEREAS, William M. Lybrand, a charter member and a former president of the Pennsylvania Institute of Certified Public Accountants, departed this life on Saturday, November 19, 1960; and,

WHEREAS, the officers and members of the Executive Committee of the Chapter have benefited from his long years of service to the Institute and to the profession, had the highest regard for him personally and have a great sense of loss on his passing,

THEREFORE, BE IT RESOLVED, That his high services to the Chapter and its members be recognized and a copy of this resolution be sent to his partners.

The Role of the CPA as a Management Consultant

By Herman C. Heiser

Within recent years, Management Consulting Services by CPAs has been receiving ever increasing attention by our profession. The American Institute of Certified Public Accountants is actively engaged in the development of Management Services through a continuing education program undertaken to provide instruction to CPAs in this field. *The Journal of Accountancy* has included an increasing number of articles during the past few years of an instructive nature to assist our profession in developing additional skills which may be applied to the solution of management problems. In addition to these, I recommend for your reading an article written by John L. Carey entitled, "The Concept of Management Services by CPAs" which was sent to all members of the American Institute in 1959 by the Committee on Management Services (by CPAs). The Committee believes that this publication will serve as a most appropriate introduction to the new series of bulletins on this subject. Many of the state societies of CPAs have formulated plans for extensive training programs in this field and many of the programs I have observed have been outstanding. It is unquestionably true that the vigorous growth our profession has enjoyed over the years is to a great extent attributable to the time and effort unstintingly given by fellow practitioners to the development of advanced technology and the *extension* of services provided by CPAs to the business community. We may conclude therefore that Management Consulting Services has become an integral part of the practice of today's CPA. However, my experience in this field has clearly indicated that relatively few business executives as yet have an image of the CPA as a Management Consultant. This situation may rapidly change as more and more CPA firms conclude successful engagements and the value of their service in this field is recognized by business executives. I predict that within the not too distant future the demand for this type of service will have increased to the point where executives will *expect* the CPA to provide this service when and as needed.

While I am responsible for the development of Management Consulting Services for a relatively large CPA firm I want to

CPA as a Management Consultant

assure you that I recognize that the vast majority of practicing accounting firms are small local partnerships or individual practitioners serving relatively small business enterprises. Consequently my suggestions are being addressed primarily to this majority of our profession. I further want to stress that if only the large CPA firms extend their scope of services to include Management Consulting then our profession as a whole will fall short of providing the services which will be expected of us by the business community since a large segment of the economy will be deprived of benefits which may otherwise inure to only the large business enterprise. In this regard I feel strongly that the CPA *can* and *must* provide skills for his clients as a group which they cannot afford to provide for themselves individually.

With the background presented to you thus far I propose to discuss three facets of the subject of Management Consulting Services:

1. How the CPA has come to be regarded as a Management Consultant,
2. What Management Consulting Services are, and
3. What the CPA must do to develop the skills and competence required to practice in this field.

The CPA as a Management Consultant

Mr. Carey in his paper previously mentioned says:

It may be startling to some certified public accountants to be confronted by the proposition that all the services commonly rendered by certified public accountants are "management services." Each service discharges or helps

HERMAN C. HEISER, a partner in the New York office, is National Director of the Management Consulting Services Division. He is a frequent contributor to professional periodicals, and is the author of *Budgeting, Principles and Practices*. Among a number of professional groups and activities, Mr. Heiser is also a member of Alpha Beta Psi, the honorary accounting fraternity. Mr. Heiser, with his wife and three children, makes his home in Ardmore, Pa. His professional concern with figures extends to his recreational activities where, together with woodworking and photography, he lists figure skating. This article is based on a speech before the Puerto Rican Society of CPAs in San Juan last fall.

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discharge one or more of the functions or sub-functions in the management area of finance and control.

Traditionally the CPA has always served management as evidenced by the fact that most local firms of CPAs serving small business derive most of their income from 1) General accounting (bookkeeping service); 2) "Non-opinion audits" (internal auditing); 3) Tax management; and 4) Opinion audits.

The CPA has always been dedicated to serving his client in the area of internal control and it is well recognized that a most important objective of internal control is to "promote operational efficiency." There are many ways of describing the role of the CPA but I think we might put it concisely by saying that he serves management as a consultant in the field of management planning and control for the purpose of optimizing profits and building a sound financial structure. While most CPAs have performed services in the field of finance and control it should be apparent that he cannot and has not limited the development of his technology to accounting. This may be clearly recognized if we consider that one important type of engagement which a large segment of our profession has undertaken for many clients is the design and installation of budget systems and programs. While budgetary practice draws heavily upon the technology of accounting and finance, the accountant has found it necessary to acquire considerable knowledge of the technology of production and inventory management and marketing. Consequently, we in our firm recognized the need to assess the problem from the point of view of the types and variety of skills required to provide effective service to our clients in this field.

Classification of Management Consulting Services

For this purpose we have classified Management Consulting Services in two ways:

1. By functional area of service, and
2. By technological competence required.

The functional classification is easily recognized by reference to the organizational structure of the clients we serve:

1. Marketing and distribution management
2. Production and inventory management
3. Financial and accounting management.

Other functional classifications, such as procurement, personnel management, research and development might be considered

CPA as a Management Consultant

to be included as a part of the aforementioned classifications or might be considered as additional classifications.

The classification of Management Consulting Services by technological skills required might be:

1. Control systems design and installation, including
 - a. Accounting and cost systems
 - b. Budgetary systems
 - c. Production control systems
 - d. Maintenance control systems
 - e. Distribution control systems, etc.
2. Measurement and evaluation methods and procedures, including
 - a. Material standards
 - b. Labor standards
 - c. Quality control methods and standards
 - d. Job evaluation
 - e. Organization structures, etc.
3. Data Processing, including the effective application and use of
 - a. Electro-mechanical accounting machines
 - b. Punch card machines
 - c. Electronic data processing machines
 - d. Communications equipment
 - e. Process control equipment
 - f. Other, i.e., data retrieval systems and equipment
4. Management Sciences and Operations Research, including
 - a. Decision-making procedure and systems
 - b. Economic analysis
 - c. Mathematical techniques, etc.

Management problems are often related to a functional area in the organizational structure. The solution of these problems, however, most frequently requires the application of several of the skills identified in our second classification of services. Sometimes management problems require the application of a single skill to all functional areas. If the latter case were always true then the CPA, with his educational background, experience and general competence in accounting and finance could, and in fact does, serve his client in all functional areas.

In an article recently published in the *Journal of Accountancy* (September 1960), Ralph F. Lewis, who is national director of management services for Arthur Young & Co., points out how a

CPA may approach an extension of his practice into the field of management services by selecting a few typical areas that stem from or border on traditional accounting functions. These are:

- | | |
|-----------------------|----------------------------|
| 1. Payroll | 6. Inventories |
| 2. Insurance | 7. A specialized industry |
| 3. Budgetary control | 8. Ratio analysis |
| 4. Distribution costs | 9. Executive compensation. |
| 5. Financing | |

I subscribe completely to Mr. Lewis' point of view, and I recommend reading his article, but I also contend that once having reached this stage of development the practitioner must go forward to develop and acquire the additional skills necessary to afford the smaller clients of our profession the advantages enjoyed today by only the larger companies.

Let us consider for a moment several of these areas:

1. *Payroll*: The advantages of applying accounting and systems skill to the function of processing payroll data for the purpose of preparing checks, making labor cost distributions, etc., is well known to all of us but management's problem is much broader. We must direct our attention to the improvement of operating results through better control and management of labor. This implies measurement, and the development of labor standards so that labor costs and productivity are kept in proper economic balance. Realization of the potential for profit improvement implies a practical working system for scheduling production so that productivity does not suffer from the lack of available work for the labor force at every work-station. These are some examples of the opportunities we have as consultants to make valuable contributions to our client's financial well being.

2. *Inventories*: The CPA can and does make a valuable contribution to his client as a result of his audit of inventories and the findings which he reports to his client. Many valuable recommendations are made as a by-product of his auditing function. However, if we stop and think for a moment, it is perfectly possible and probable that inventories which meet all criteria and tests from the financial and accounting viewpoint may be "sick" from an operational viewpoint. Individual parts in stock may be out of balance, excessive "stock-outs" may be characteristic, poor inventory turnover may be frequently experienced. In my opinion, our clients may soon expect this type of diagnosis from his auditors.

If we were to pursue our investigation in other areas, I assure you, we would find evidence there as well that the CPAs interest must broaden.

Development of Management Consulting Competence

Earlier I stated that the vast majority of our profession are relatively small firms and that my views are addressed to that

majority. We are now at the point of facing the problem—what the CPA must do to develop the skills and competence required to practice in this field.

Mr. Lewis offered three admonitions to the CPA in his article:

1. Do not fear going beyond pure accounting and auditing.
2. Do only what you can do well.
3. Do not feel you have to be competent in all fields.

I believe the CPA must overcome the fear of going beyond pure accounting and auditing first. He must be convinced that he may rightfully extend his scope of services, that his clients expect or will expect this of him and that he can make an important contribution to the financial well-being of his clients.

That he will only do what he can do well is the cornerstone of our profession and I have no fear that the CPA will risk his reputation by undertaking work for which he is not competent.

Our problem resolves itself, therefore, to the matter of competence available to the CPA as a natural result of his training and experience and the formulation, by each practitioner of a program for the development of broader skills.

A review of a typical curriculum offered by most university schools of business leading to the qualification of a candidate for the CPA Certificate will disclose that his training is planned on a much broader base than just auditing and taxes which are only a few of the courses he takes. His training usually covers the broader field of financial management. If the practitioner were to direct his interest toward this broader base his experience will develop to match his formal training. As a result he can offer to his client a valuable service which many practitioners seem to overlook. Perhaps this is because he does fear going beyond pure accounting and auditing. I contend that such fear is groundless and that he will soon discover that he can become a management consultant in many areas and that in this role he can meet the same high standards of quality our profession demands in the auditing function.

Having developed to this point it will become evident to the practitioner that complementary skills are needed to better serve his clients. Knowledge of control systems in production and marketing; the application of new equipment to data processing systems; and the ability to install procedures for establishing standards of performance and measuring productivity are examples. There are many ways to acquire these additional skills

and I am sure that you already know some of the means available to you. The most important step, however, is *to make the decision to go ahead* and then the devotion of adequate time by the practitioner and selected members of his staff to acquire the skill. In this connection, I know of no easy or automatic way of acquiring knowledge and experience. The CPA must make up his mind to invest the time and effort and then assign this task to designated persons and, most important, detach them from the auditing practice to develop management consulting services. (This cannot be a part-time job.) Many CPA firms have admitted to the firm or added to their staffs men with experience in management. CPAs who have left the profession to become business executives and have had diversified experience in several management areas can be extremely valuable to a firm as a Management Consultant. The increasing importance placed upon this area of service by CPAs has attracted many of these men back to the profession. The acquisition by a CPA firm of staff members with skills in the production and marketing fields is becoming quite common in the United States, United Kingdom and Canada, and the smaller practitioners should not hesitate to follow this practice. There is no reason for a CPA to limit the skills available on his staff to accounting and taxes once a decision is made to develop a more comprehensive line of services.

Of course, this does not relieve the CPA or partners of the firm of the responsibility for self-development in the management consulting field particularly with regard to the technology required in the Production and Marketing functions of management. It is the philosophy of our firm (and this is shared by the profession generally) that we cannot perform services for clients unless at least one partner or principal is competent to perform such service and to pass upon the quality, effectiveness and technical aspects of the service.

I know that this carries with it a financial investment and that the CPA must decide what he can afford. But whatever the amount it should be invested and the greater the amount available for investment in such a program the faster this service will grow. With many smaller CPA firms and with individual practitioners this approach may offer little prospect of accomplishment within a reasonable time period; therefore, what alternative may be feasible for them? From some recent experiences of our firm I might suggest the desirability of associating with a firm who has

broader Management Consulting competence. This does not mean absorption of the smaller practitioner. We as a large firm have found it to *our* advantage as well to establish a close and exclusive association with smaller firms who retain their individual identity.

Conclusions

It would seem appropriate now to draw some conclusions from the matters considered:

1. Management Consulting Services have already become an integral part of the practice of the CPA.

2. While a great number of executives do not yet have an image of the CPA as a Management Consultant, this is rapidly changing and our profession as a whole must be prepared to provide management services to our clients when this demand arises or our clients may seek this service elsewhere.

3. Development of Management Consulting Services by only the larger CPA firms is not enough. The large segment of the business community served by smaller practitioners is also entitled to this service.

4. Traditionally the CPA has always served management and his role as a Management Consultant is presently more clearly emerging.

5. The CPA must broaden his skills so that he may serve all of management rather than restrict his services to the functional areas normally associated with the financial and accounting executive.

6. Smaller practitioners should gradually extend their services to include financial planning, budgeting, cost accounting, and systems and procedures to all clients. The best place to begin is budgeting which leads naturally to other functions.

7. In due course, as the next step, the CPA will find opportunities arising to assist his client in production planning and scheduling; inventory management; and several functions of marketing such as forecasting and planning; distribution cost control and product profit analysis.

8. The CPA must develop a program for himself to gradually acquire additional competence and skill through current reading, attendance at management courses and if possible by association with other practitioners who can help him serve his clients during the early stages of his development but most importantly to protect his professional reputation while he acquires actual on-the-job experience as a Management Consultant.

In closing I would like to borrow these thoughts from Mr. Carey's paper:

. . . (the) practicing certified public accountant might come to be looked upon somewhat as physicians of business. . . . It is axiomatic that no one stands still. . . . It seems reasonable that the accounting profession can expect to move forward in this highly competitive, rapidly changing economy only so long as it identifies itself with the welfare of its clients and the community.

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Extension of services to management by certified public accountants offers opportunity for normal healthy growth, soundly based on foundations the profession has already built in the seventy-two years of its organized existence in the United States . . . such extension of services offers an opportunity to strengthen the . . . economy by improving the financial position, profitability and competitive strength of small business.

CPAs could be the conduit through which principles and procedures applied successfully by big business . . . could be made available to strengthen the millions of small businesses (served by our profession).



Last fall George A. Hewitt of Philadelphia, partner in charge of the Southeast Regional Office, addressed his British colleagues in London's Goldsmiths' Hall. The occasion was the Members' Dinner of the Institute of Costs and Works Accountants. Seated at Mr. Hewitt's right is P. F. Barrett, O.B.E., Deputy High Commissioner for the Federation of Rhodesia and Nyasaland.

Effects of EDP on Internal Control

By Felix Kaufman

Electronic data processing (EDP), with its never ending flow of improvements, represents something foreboding and mysterious to those concerned with controls over information processing. At the bottom of this anxiety there is the difficulty of understanding what electronics can do and how it does it. In addition, the sparse literature is heavily weighted with dramatic observations like the following:

No development in modern times promises to make as great an impact on record keeping as the introduction of electronics into the office. Responsible personnel of enterprises contemplating the use of electronic equipment are well warranted in their concern about the many problems that may accompany these changes. Included among these problems will be those relating to auditing. Thus, independent accountants must consider the audit problems likely to arise and be prepared to cope with them.¹

Control-conscious individuals are bothered, or at least perplexed, because electronic data processing may have such a profound effect on the external aspect of the paper-work world. In fact, electronic data processing alters the appearance of that world as much as any new tool possibly could. In a computer room all of the familiar trappings are gone—there are no papers, no files, no desks, very few people, and hardly any of the other accoutrements of the usual data processing operation.

These individuals are further perplexed because of their traditional attitudes toward the role of system improvement. They have not been indifferent to procedural changes and improvements. Usually, however, they have been able to assume that changes in methods of collecting and analyzing data do not appreciably influence the basic nature of control processes or the way in which they are carried on. They have adapted to many such changes without difficulty. The question is whether their adaptations may be as well and as promptly achieved with respect to the new changes which are so much more dramatic in outward appearance. Where do the people who are concerned with the control of infor-

¹ J. R. Murray, "Auditing Electronically Produced Records," *The Canadian Chartered Accountant* (February, 1957), p. 117.

mation stand in the new world of paper work, one without paper, in which records are kept in forms unreadable by their eyes?

It is important for these individuals to have a complete understanding of the nature of this new tool and the range of its capabilities. This will not lead automatically to the quick adaptation of their methods to an EDP-dominated accounting system. However, it will prevent them from doing things that are conspicuously wrong or unnecessary; perhaps more importantly, it will enable them to deal with electronic data processing persons, who may be convinced that they know how auditors should behave in this new world.

The adequacy of internal control establishes a point of departure in auditing since it serves as a gauge of the effectiveness of a system in following its procedures. Therefore, a consideration of the effect of electronic data processing on auditing should place considerable emphasis on the nature of the internal control system which arises in conjunction with the use of computer processing.

It seems fair to say that the ultimate in internal control is achieved when the control features are integrated so effectively into procedures that the acts which implement procedures also implement control. In such a system the vigilance required to prove that controls are functioning does not come about by taking measures which also must be controlled. Instead, the vigilance is built in so that the system is self-disciplining.

Systems employed to date, using manual and semiautomatic means for processing, have not achieved these internal control goals. Their controls are, in a sense, a separate procedural system,

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even though superimposed on regular operating procedures. The effectiveness of these controls depends primarily on the continuous vigilance of people whereas in electronic data processing the means to integrate the procedural system and the control thereof is present. Accordingly, in this article an investigation of the extent to which a self-controlling system can be constructed will be undertaken. Such an investigation will emphasize the following points:

The extent to which an electronic system automates measures of control.

Whether some generally accepted measures of control are unnecessary in an electronic system.

The techniques employed to assure control have been classified as a way to obtain a point of departure for an investigation to consider these points. In this connection it would seem that the points of control indicated by bold arrows on the charts which appear in the publication "Internal Control"² represented a comprehensive set of individual steps.

The main categories in the system of classification evolved are as follows:

Measures based upon the consistency of information

Measures based upon the "meaning" of information

Measures based upon comparisons of source data

Measures based upon "outside" checks.

Organization of clerical work:

Separation of duties

Co-ordination of paper work with physical processes.

Each of these points is developed below briefly to give the reader an understanding of the segment of control it represents. Subsequently each area is considered as a method of control in EDP systems.

Measures based upon the consistency of information. **PROOF TOTAL TECHNIQUES.** The accuracy of data transfer, of batching, and of specific calculations is tested by comparing accumulations of posted amounts or others.

1. *Pre-Listing:* Amounts to be posted, or quantities accumulating to a hash total, are summarized in an operation preceding, and independent of, posting. A proving summarization occurs during posting.

²American Institute of Accountants, *Internal Control*, New York: American Institute Publishing Co., 1949, p. 1-24. These charts appear in the book and were used as a basis for describing applications in material preliminary to this article.

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2. *Multiple distribution:* If two or more postings occur for each transaction in a series of transactions to be posted, a proof is given by the comparison of total postings to each file.

REVIEW FUNCTIONS. Accuracy is based upon inspection processes by means of a "formula" for determining the validity of information such as prices, discounts, numerical sequences, and the like.

Measures based upon the "meaning" of information. The validity of data is established on the basis of "meaning" (as distinct from the review function where validity is based upon a "formula"). In employing this type of control, the intent is to examine information in order to authorize or approve some action. Included are such actions as sales return approval, credit approval, and the granting of allowances and discounts.

Measures based upon comparison of source data. The accuracy and adequacy of clerical work is established by comparing original documents relating to a certain event. These comparisons usually develop from two conditions:

1. Documents develop independently but contain common information which permits comparison.
2. In the course of a series of related operations, documents originate at successive levels of activity in connection with the processing of a single event. The common information on these documents, independently entered, permits a verification process to be carried out.

Measures based upon "outside" checks. **OUTSIDE SOURCE DATA.** Source data developed by others are used to prove internal operations.

PHYSICAL CHECKS. Operations involving physical acts directly on assets, such as inspection or counting, produce information confirming data processing activities.

Organization of clerical work. Superimposed on these measures are the organizational arrangements made to facilitate implementation of methods.

SEPARATION OF DUTIES. This includes all arrangements designed to effect a division of related activities.

1. *Separation of record-keeping processes:* Related clerical steps are performed by different people.
2. *Separation of physical processes from record-keeping:* Heightened control is achieved by separating the handling of assets from the access to records associated with the assets.

CO-ORDINATION OF PAPER WORK WITH PHYSICAL PROCESSES.
When paper-work operations direct and co-ordinate physical activities, control arises from the fact that co-ordinating documents are issued only when there is satisfactory evidence of prerequisite activity.

CONSISTENCY OF INFORMATION

Internal Consistency—Proof Totals. Proof total concepts are simple; they would appear to require no special attention in any system. That is, we might assume that the technique would be applied just about the same way no matter what procedural arrangements were used. This is not exactly the case in electronic data processing. There are some complications and some unusual considerations.

The nature of equipment, particularly as it affects the organization of files and the method of introducing transactions, is important in considering the operation of proof totals. When processing is governed by the order in which files are kept, the conditions for the use of proof totals are conventional. Where random access files are employed or where transaction recording is on-line with processing, the proof total arrangements are unconventional. These conditions are discussed in detail in this section.

In addition, factors that affect system design influence the way in which proof total methods are employed. In this connection the tendency in electronic data processing to consolidate files and types of transactions for processing, and the powerful editing (data checking) features of computers bear upon control arrangements.

The proof total approach may be used to test:

1. The accuracy of a transaction batching process
2. The transmission of a batch through one or more handling operations en route to processing
3. The accuracy of certain processing steps.

The computer's unusual and inherent accuracy considerably reduces the possibility of error in (3). It is possible that with electronic data processing we may be virtually free of this kind of error. This means that proof totals will operate primarily to establish the accuracy of totals established in order to prove the accurate movement of data [points (1) and (2) above].

Accordingly, a conclusion about proof total methods in an electronic data processing system is this. Of two primary goals, relieving the data collector of responsibility and proving the accuracy of posting, only the former remains. This comes from the very substantial increase in the inherent accuracy of processing.

Since the operation of a proof total procedure meets the above goals simultaneously, the elimination of one objective does not reduce the amount of control effort required. As long as data sources and data processing are separated, some control to prevent inadvertent or deliberate tampering with transferred information is still required. It is desirable, however, to understand the change in emphasis from posting accuracy to transmission accuracy, particularly since this knowledge should help the auditor to avoid the criticism he would be subject to if he makes a time-consuming effort to check the computer's calculating ability.

Effect of the type of equipment on proof total methods. The concept of a batching process is fundamental to proof total technique, since it is the accumulation of input that produces a control total. The question of whether electronic data processing methods require batching is important. If they do not, proof methods require extra procedures, thereby adding to inefficiency in the sense that something special needs to be done.

Sequenced techniques require batching because it is necessary to put transactions in order according to some predetermined key. To achieve this order, transaction data must accumulate. This results in a batch which we can identify in the usual way with a control total.

Random access equipment does not require ordered transaction data. Therefore, it does not, *per se*, require batching for its own purposes. However, batching does not necessarily involve sequence, and batches may be created in random access systems without entirely compromising the random principle.³ In other words, we cannot order without batching, but we can batch without ordering.

³ The random access principle is not compromised completely because sorting is avoided. To some extent the on-line ability of the system is compromised. This is the ability to process an event shortly after it occurs, or immediately upon its receipt by the data processing center. The compromise comes about because the time required for batch accumulation delays processing.

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For example, in demand deposit accounting, any group of "on-us" checks with an associated control total can be posted directly into a random access system. Here there is a batch, and although the checks themselves are eventually sequenced, the posting media made from the checks (cards, paper tape, etc., or on-line operation through magnetic ink) can enter the posting operation without sorting.

It is relevant here to consider what will happen if a system allows each event to arrive at the data processing center by itself rather than as a member of a batch. This is what happens when the recording of a transaction is automated and placed on line with the processing units. Such an approach allows the processing system to take action reflecting the effect of some event in a very short period of time; the action and the event can be almost simultaneous.

This situation appears to eliminate the proof total environment. In the first place, there no longer exists a responsibility center which batches to prove that it has fulfilled its data collection obligations. In the second place, transmission from collection point to processing center is accomplished by electronic processes. However, there is no need to be dismayed by the inability to apply control totals, because the errors controlled by proof totals are minimized by on-line transmission. These are the errors which occur during batching and transmission. An error in recording an event is irrelevant to this consideration because proof totals do not control these cases.

Automated transaction recording processes are not foolproof as far as avoiding the creation of incorrect data. However, control total techniques do not have anything to do with the purification of bad information.

Figure 1 (p. 41) illustrates the variety of equipment arrangements discussed. In Case I the events do not have to be batched because of random access features. In addition, the transaction collection process is on-line, so that there is no opportunity to batch. This arrangement is acceptable when the total automation of data collection and posting implies a level of reliability which makes a proof total method unnecessary (particularly since possibilities of error in data transmission are so low).

Case II puts the transaction recording process off-line. This implies time delay to get transactions to the processing center. Time delay means batching. In this case we are able to construct a proof total procedure.

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Sorting is shown as an optional step in Case II. With current random access equipment, sorting will speed up processing times but is not otherwise necessary.

In Case III, transactions must be sequenced according to the order maintained for the records in a file. This requires batching and sorting and is typical of systems based on magnetic tape (as well as punched cards and ledger cards used with bookkeeping machines).

Role of system design. The optimum way to operate a control total run is in combination with regular processing operations. This is no different than the situation whereby a total is obtained as a by-product of posting on a keyboard accounting machine. However, several considerations in electronic data processing tend to prevent the utilization of a simultaneous (posting and proving) approach. These are:

1. The tendency in electronic data processing to consolidate files
2. The tendency in electronic data processing to consolidate transaction data
3. The requirement for separate editing runs.

Factors favoring consolidated files. The integrating capability of electronic data processing results from the ability to consolidate files. Data kept in various places dealing with the same subject (customer, vendor, employee, stock item, etc.) can be brought together to avoid redundancy in storing information, and to significantly reduce the degree of co-ordination normally required to process events affecting several files. However, since consolidation lengthens individual file records, good procedural design now emphasizes the minimization of the number of accesses to file records. This object is fulfilled if all transactions affecting a particular record can be processed at the same time when a file is updated.

This condition is unfavorable to batch processing since it consolidates transaction data, thereby destroying original batches unless we can preserve the identity of each after it has been merged with others.

Another way of describing this tendency is to consider the pattern of transaction groups which exists on arrival at the EDP center as the natural batch. Thus the arrival pattern provides the unit to which a control total is assigned. But this is not the natural unit for processing. A much larger group of events ought, in general, to be assembled for that purpose.

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Consolidating transaction data. As files are consolidated, a larger number of different types of transactions can be handled in one run through the processing unit. Therefore, file consolidation is an incentive to increase the variety of transactions brought together for processing. However, the consolidation of transactions can be an independent aspect of system design. Given the content of a file record as a fixed condition, we may bring together different types of events if their processing requirements will be met by the information held in the file. Therefore, the consolidation of files and transactions interact upon each other with an associated breaking up of the batches in which source data arrive.

In other words, either of these tendencies changes the order of transaction data from their condition when received. File consolidation does this indirectly by promoting transaction consolidation. Transaction consolidation has a direct effect.⁴

Effects of computer editing abilities. An EDP system has unusual capabilities, because of the characteristics of the computer, to examine each element of information processed by it. This editing process involves the ability to inspect and accept (or reject) inputs, according to the validity or reasonableness of codes, quantities, and other data that can be checked in the transaction record. The tendency in current electronic data processing system design is for operations which accomplish editing to be separate computer runs, thereby keeping apart the purification of data and its processing. There are two reasons for doing it this way.

A run that edits and updates at once may strain the high-speed storage capacity of the computer, particularly if the editing processes are extensive. Although they are not nearly as limited in instruction storage capability as people are, computers still may be in a "program limited" state (wherein one cannot do as much processing per event on a given run as desired because the computer cannot store the entire instruction sequence) for a specific application.⁵ One aspect of systems design to fit this condition is the separation of the editing run.

⁴ In the present state of the art, consolidation of both file records and transactions only approaches the ideal. The principal moderating influences are limited high-speed storage (both for programs and data) and complications in system design which frequently reflect organizational difficulties.

⁵ However, the condition varies considerably by type of system and application. In general, the bigger and more expensive systems provide more high-speed memory and are less program limited.

When transactions are rejected through the use of editing programs because of defects in content, the situation is handled better if the edit function is not part of regular updating. This is because no part of a master record will have been modified at one moment, only to have the effect invalidated a moment later because edit steps rejected the transaction. Nor have outputs (reports) been developed which must then be "called back."

The foregoing observations lead to the construction of the following logic to apply to batch requirements:

1. If editing considerations are complicated, they should be incorporated into computer runs separate from processing.
2. Editing runs do not require files. Accordingly, they raise no ordering requirements.
3. Natural batch conditions can be maintained during editing runs.
4. Proof total methods applied to transactions data should be incorporated into editing procedures.

This approach does not violate the integrating tendency of electronic data processing which we spoke about earlier. Between the editing and processing runs, different types of events can be consolidated by sorting and merging to create the longest practical transaction grouping.

Combining editing, proving, and processing. Theoretically, at least, the most efficient arrangement to accomplish editing, proving, and processing combines them into one computer run. Two factors favor the combination of these activities into a single run.

1. There is only one handling of transaction data. The time saved might be important in terms of equipment and personnel reductions.
2. When editing occurs as a by-product of updating, there may be no necessary increase in computer time to perform the additional steps. This is true if the machine is not "computer limited"⁶ on the application being considered.

If it is possible to set up a consolidated run, we need some way of proving back against batch totals, even though batches have been broken by the reorganizing of transaction data. This proof can be effected if each event subject to control can be identified with respect to the batch it once belonged to. The identification may be natural, via data already associated with the event (as in

⁶ "Computer limited" is a term used to describe the condition which exists when the time required to perform steps inside the computer exceeds the time needed to get data into and out of the computer. If these processes are overlapped, as they frequently are, the longest, timewise, holds up the others.

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the case of a geographic code), or it may be assigned arbitrarily. In the latter case, assignment should ideally take place when the data, upon arrival at the EDP center, are transferred into machine language by transcribing.

For example, this could occur in the conversion of cards (or other media) to magnetic tape. If the card reader has the ability to add information (some do), this is precisely the skill needed to insert an arbitrary code.

There are indications that we may proceed in this manner in demand deposit accounting. The inscribers required to code the amount of a check to magnetic ink characters can also assign a batch number. Therefore, if subsequent steps are performed by machines with sufficient accumulation capacity, proofs against original batch totals can always be established even though the batch has been broken in its physical sense.

Given the ability to code the batches prior to the computer run, we can ask the computer to run many control totals simultaneously. It would print them at the end of the run; or, if the details comprising the totals are important, print them in detail. The detail approach would facilitate checking back against a prelist, if one were provided, to locate missing, superfluous, or erroneous items. The rough form of a report to accomplish this is shown in Figure 2 (p. 42). The computer has assigned each posted amount to the column which identifies the batch for which this amount is a member. This provides the details of batch totals even though batch sequence was not maintained during processing.

In using a control total proof, convenient access to original documents may be necessary in order to check specific quantities. This is always possible when proving is a separate run because the basic data have not been regrouped. That may not be the case on a combined run, however, if the original information arrives in one of the various machine-language forms. If the data are already in machine form (punched cards, for example), transaction consolidation may occur by sorting and merging the cards, in which case any lookups in connection with the proof operation will be more difficult to accomplish.

Of course, if we go back far enough, some other level of source data can be found, such as the basic information from which the cards were made. A possible exception occurs under geographic conditions which make the cards or paper tape the end product of a communications system; then, reference to the original written source could be inconvenient or impracticable.

Time considerations⁷ may obstruct efforts to assemble small batches into large ones. If so, processing occurs on a batch basis, thereby making academic the obstacles discussed earlier. One should keep in mind, however, that such an approach may be accompanied by some breakdown of the files to fit the arrival pattern of the information.

Conclusions about proof totals. To summarize the foregoing:

1. Computer systems emphasize the proof total control for checking the movement of batches. The accuracy of a computer de-emphasizes the proof total as a posting check.
2. Developments in random access equipment and in on-line transaction recording eliminate the need for batching as a preliminary to processing. Batching becomes a special requirement imposed by proof total procedures.
3. The automation of connections between recording and processing is likely to cause the elimination of batch methods as tests of transmission accuracy.
4. At present, the consolidating tendencies in electronic data processing promote separate computer runs to implement some control features, including proof total tests, on transaction batches.

Internal consistency—review functions. The inspection of data by independent parties is a verification technique. By reviewing information, individual elements of data and whole events are confirmed, adjusted, or rejected. As a method of internal control, review increases the degree of specialization in a data processing system by intervening into the processing flow exclusively for control purposes.

In an electronic data processing system this intervention is uneconomic because of the translation of data needed to make it intelligible to the reviewers. The costs of transferring information from, and back to, machine-sensible media are considerable. To minimize this cost and to prevent interruptions, there are two practical courses of action. The first shifts the review function so that it is placed either at the beginning of a process (just after data are created) or at the end (when all automated steps have been taken). The second method incorporates this control step into the EDP system itself. This is better because it furthers the goal of extending the range and penetration of computer processing wherever possible.

⁷ Let transaction data be received from Branches A and B. Consolidation of A and B can occur only after both batches are received. The waiting time might be prohibitive, in which case processing begins when the first batch arrives.

"Automatic review" is practical in connection with routine inspection activities. People performing these jobs are, broadly speaking, doing two things. They compare certain data items with tables, or they judge these items with established standards whose values they have memorized to determine that these are "eligible" for use. People also inspect data for compatibility and to determine the reasonableness of magnitudes. A computer can do all of these things. It is easy to "teach" the computer, via program, the members of a list of eligible values.

Electronic methods are clearly superior in this area. Yet, it is this very superiority that leads to much undeserved criticism of electronic data processing systems. Their screening capabilities result in the implicit adoption of input accuracy requirements which an organization finds itself unaccustomed to, and which it frequently considers unbearably rigorous. Accordingly, the machines are blamed when the problem is really to be described as one of data. The following examples taken from actual experience will make this more apparent.

In two installations, several control problems developed as a result of the incompatibility of the controls provided by the computer and those that were to be maintained by related activities, for example:

1. The computer program checked prices on input media against prices in the retail inventory record. Markups and markdowns, particularly in conjunction with sales and special events, had to be phased properly to change inventory prices before sales were reported at new prices. Getting buyers to co-operate in reporting price data on a timely basis was very difficult. But, when the phasing was incorrect, the reported sales prices (perfectly good transcription data but not timed correctly) were rejected by the computer. In the last analysis this is a problem in system design; the designer should be able to recognize important external conditions and reflect them in his procedures.

2. The electronic data processing inventory record showed on-order quantities as a check on the amounts actually delivered by vendors. However, it was typical that some vendors would substitute colors and sizes on garment requisitions without informing the buyer. The department store tacitly approved this by flexible receiving room procedures. The computer could not accept the unauthorized substitutions; it therefore brought these to the attention of buyers.

3. Accurate inventory records depended upon sales clerk discipline when merchandise exchanges occurred that did not involve price differences. The clerk should have executed a new sale and recorded a separate merchandise return. However, this was often overlooked because there was no price difference; but the effect was to have two inventory records in error.

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4. An oil company used a computer to check specific gravity calculations on oil run tickets. In the field the calculation was established by the use of a table; the computer, however, used the full formula, and solved it for each report, making every calculation. An analysis of discrepancies showed that the field people had discovered errors in the tables from time to time. These errors were such that they would affect all table entries following the one in which the initial error occurred. The clerical burden of changing all the table values was too great to make all these changes. Accordingly, reporting errors were allowed to go on, tolerated because of the table errors. However, the electronic data processing system rejected all incorrect data.

When circumstances like these are encountered, the EDP user must either attempt to raise the level of control in performing regular functions, or he must relax the EDP controls to correspond with actual procedures. The latter course assumes that greater discipline cannot be achieved in these other areas and is a valid course of action only if that assumption is correct.

There is a tendency in this connection to impugn the goal of designing the most rigorous system possible. This reflects a "what we don't know won't hurt us," attitude based on the erroneous assumption that a "quiet" system—one with a high error rate but low detection rate—is really efficient. A rigorous system is desirable *per se* and should be compromised only when the costs of obtaining it are greater than the benefits produced thereby. A mark of this condition appears when other control elements, mainly people, cannot harmonize their activities with a rigorous electronic data processing system.

We may conclude this section by placing additional emphasis on the heightened role of data review as a method of control. Computers have unusual powers to implement this technique. However, it is not an automatic skill; it must be programmed.

In EDP systems we can expect a transfer of this type of control from manual to computer methods.

The rigor one can get from a computer approach in this area may have adverse psychological effects on an organization. In most cases this should only be a short-run problem.

MEANING OF INFORMATION

Control is also exercised in a data processing system through the performance of an authorization function. This involves more than inspection of data in the sense of the previous discussion. To some extent an interpretation of data is required which cannot be formalized by rules or tables. This process which, in a sense, depends upon the meaning of information, results in the deter-

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mination of the type of event caused by certain data conditions. Granting or refusing credit, writing off bad debts, and authorizing returns and allowances are examples.

These situations are not ordinarily thought of as processes that can be mechanized, since the steps taken are not readily perceived as a sequence of repetitive, routine-type actions. Normally they are thought of as combining intuition, judgment, hunch, and routine investigative steps in an indefinable blend which cannot be reduced to a series of steps to be executed in a predictable order. Accordingly, they appear to be "unmechanical" and not feasible for handling by a computer system.

If one accepts this conclusion, one gives up too easily. All of these evaluation activities have components which can be reduced to an orderly pattern. The problem is to separate the elements, a problem compounded by the very natural tendency (on the part of people who perform these activities) to overlook or refuse to admit the presence of routine procedural conditions. They may feel that such an admission would detract from the stature of their work and thus reduce their own standing.

However, it should be noted that credit review, for example, makes use of some factors that can be supplied from records (such as prior payment experience, customer size, order size, and volume of business received from one customer) as well as the intuitive factors (such as the customer's current and prospective business potential, economic conditions in general, and the seller's economic condition).

Efforts to handle these conditions to some degree with automatic methods are desirable for several reasons, notwithstanding that credit review and similar types of control situations are complex, both as to the definition of individual elements and the assignment of weights to produce the correct "blend."

Through automatic processes the exception principle may be used more effectively. The process of evaluation can be divided into two phases: a selection process to segregate the conditions needing special attention, and the special attention process itself. The selection steps emphasize the use of objective criteria; the special attention process emphasizes the subjective factors use of automatic techniques in any evaluation-review function. The more precisely the objective factors⁸ are defined, the easier it is to

⁸ The review of orders in connection with credit approval is illustrative. It is common procedure to send orders to the credit department, where they are reviewed. The majority are approved quickly, having passed some simple tests. The remainder receive more elaborate treatment. The exception approach strives to automate the processes involving the simple tests.

do that part of the selection by machine. The high-level evaluation process is left for skilled individuals, who are then free to put all their efforts on the subjective phases of evaluation, applied only to the cases where they are needed.

Applying the exception principle is tantamount to determining the feasibility of an application. If a process can be automated to the extent that it can be made to select certain records for specific attention, it may be worth automating even though it cannot implement the procedures these "difficult" records must pass through.

The most important gauge for applying automatic screening-out ability is the volume of difficult items. Obviously, if all records require attention, screening is absurd. The "right" volume depends upon the data processing characteristics of each case, although we may generalize to the extent of saying that the number of records selected is usually a small fraction of the total file, and that they are randomly distributed throughout the file.

There is another benefit of a subtle character in this kind of review. This is based on the proposition that the automation of a fairly sophisticated decision-making process includes a mechanism for continuous improvement of the machine program being employed.

Suppose that doubt exists as to whether a computer program for a particular evaluation process can be written. If such a program were written, the answers given by it would automatically be questioned by the people using the results since they would suspect the adequacy of the program; moreover, they might also question whether an adequate program could be constructed at all. But if the attempt is made to develop a program anyway, one may expect certain consequences. The answers provided will be subjected to review by skilled individuals (including the skeptics) who have only three choices; they may affirm, refute, or modify the machine decisions.

Each review situation thus becomes a laboratory problem; it provides the reviewer with another opportunity to state the process as a series of discreet operations. Usually this results in a better statement because the review of a specific situation sets up more realistic conditions than those examined initially. In addition, the second view of a situation is likely to be better and more comprehensive than the first.

If the reviewer affirms the machine's decision, he confirms the program, at least as it applies to that particular case. If he modifies or refutes the decision, he disputes the program. These differences resulting from review can be classified as follows:

1. He has used knowledge that cannot be incorporated into the program.
2. His disagreement reveals the existence of new factors that can be included in the program.

This process should result in a stream of program improvements which, in a sense, are automatic, because they are produced through the operation of a feedback device, namely, the criticism of the initial result.

Naturally, this process of improvement should raise the skill and objectivity of the program, and the number of manual repudiations should diminish. However, most review functions are not likely to converge to a completely automatic condition since these are not cases in which the feedback process can operate rigorously.

Figure 3 (p. 42) is a schematic representation of this process.

Where it can be of major assistance in screening out those items requiring "outside" review, the EDP system plays an important role as an adjunct to a vital method of broad system control. This method is much more effective in a computer system because of the scope and frequency of review possible through efficient screening.

Measures based upon comparisons of source data—Independently generated documents. In those situations where it is appropriate to produce two or more source documents containing information pertaining to the same event or events, the significance of electronic data processing is in its ability to make more through those verification processes which flow naturally out of the presence of several source documents. A computer can be asked to compare all common data elements or any portion thereof.

An important example of this condition is the reconciliation of time reports and clock cards in payroll accounting. The reconciliation verifies the time report.

An element of information on one document (or a combination) and some other element (or combination) on another document can be compared for agreement or disagreement or for other predetermined relationships in data. A computer can compare different source documents to prove that they tell the same story, different aspects of the same story, or different stories. These possibilities may be combined in many ways to provide a very

flexible tool to make those verifications which can be established by source-data comparisons. All must be anticipated in the program, however.

A computer system probably will also serve to broaden the use of this method of internal control. It is not uncommon today to find that such comparisons are not made, or are made only partially, because of a lack of facilities or resources.

Computer comparisons may have interesting uses. Consider, for instance, the value in being able to compare information returns, pension reports, income tax data, and the like by the federal government.

These instances remind us that the presence of information does not guarantee its effective use. In other systems the same information may have been stored but without the means to get to it or to associate it properly.

Co-ordinating related operations. Certain applications in business-data processing characteristically involve a series of events leading to a culminating event. At various intervals in this process, source documents are created to co-ordinate and authorize the continuation of the process. When the capabilities of electronic data processing are properly exploited, the initiating source information would be stored within the computer system. As impulses (actions) come along which signal the readiness of physical activities to proceed, the basic source data are used to produce co-ordinating and directing "paper." Subsequent impulses may add or subtract data from the initial pool, but it is the latter that is used to advance the process.

Purchasing activity illustrates this. Initiating information is found on a requisition. As the process develops, a purchase order is written, and follow-up data may flow between customer and vendor. A receiving advice is created, an invoice is received from the vendor, and a remittance document is made to accompany payment. As adapted to electronics, this process would at the onset store the initiating information (the requisition), provide enough data to the "outside world" to keep the flow of activity going, and continue to direct the process, as additional information was received. Each successive document would thus be based upon the same basic pool of information.

Measures based upon "outside" checks. In another form of source-data comparison, control is obtained by the use of docu-

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ments coming from outside sources. The EDP system can process this information as readily as it does internally generated data, but it cannot also prepare these "outside" documents, although there are some developments where separate data processing systems communicate automatically with others, even though the systems belong to different business entities. (Here information remains in machine-sensible form; automatic output of one system becomes the automatic input to other systems.)

Conclusions concerning source-data comparisons. In general the findings regarding the influence of electronic data processing on the control achieved by comparing data on various source documents are as follows:

1. A computer system makes it desirable and practical to increase the volume, scope, and capability of source-data comparison.
2. The same nucleus of information will be used wherever possible to produce consecutive documents; the electronic data processing system will do the producing. This increases the probability that source information is accurate and makes some source-data comparison actually unnecessary.
3. There is no impairment of the ability to check data by using documents prepared by other systems. The tendency for independent systems to communicate automatically is growing, thereby promoting the automaticity of this form of control.

Organization of clerical work—separation of clerical duties. When a computing machine takes over a series of clerical steps, it appears to violate the separation principle of internal control. Where before an elaborate net work of specialized activities accomplished checking, nothing now remains but the figurative "black box" that devours information and produces specified outputs. What goes on inside is not visible; it must be taken on faith, or so it seems. At first glance the computer system seems to upset a basic tenet of internal control.

To get a better idea of the computer's behavior, it is appropriate to liken the machine to a versatile clerk, someone of superior ability. Such an individual might be able to handle a multitude of different events and situations as they occur, thereby dispensing with the need for specialization, since specialization is, after all, an adaptation to the shortcomings of people. It maximizes the efforts of individuals who, in computer jargon, are seriously "program-limited." The versatile clerk concept is a throwback to the methods of the high-stool, green-eyeshade days when low volumes and less complex procedural conditions per-

mitted one person to process a transaction through all of its ramifications. Now computers do the same thing except that they are not awed by high volumes, and do not need to accommodate their versatility to the special requirements of volume.

To a computer the transfer of activities previously performed by many people to one "person" is not a surrender of internal control, notwithstanding the reduction in specialization. In fact, the kind of control attributed to separation is heightened by electronic data processing machines. The explanation of this proposition follows.

There are two ways to be inaccurate: deliberately and inadvertently. Deliberate errors require planning; and if the plan is executed in the presence of effective control, it also requires collusion. Computers do not plan and cannot collude. They are deliberate only in the sense that they execute the steps indicated by their programs. Knowing that a given program is in use, one can be certain that only inadvertent errors can occur in its execution. The machine does not know how to be "disobedient."

Computers can disobey, indirectly, if their programs are manipulated. People create and maintain these programs and can alter them for undesirable ends. Accordingly, a shift in the distribution of authority over a system has occurred and should be recognized. The concentration of control over computer operations lodged in the system designer compels us to pay close attention to the techniques used in design and to the procedures used to maintain and alter programs.

In effect, all of this says that, although the adequacy of procedures cannot be taken for granted, adherence by the computer to any given procedure is practically guaranteed if measures have already been taken to establish that the program in use was developed by authorized personnel and will do what it purports to do. Since separation methods are aimed at adherence to procedure, not the question of procedural adequacy, the absence of conventional specialization in electronic data processing seems unimportant.

It is also worth noting that it is possible to liken a computer's processing to an activity characterized by complete separation of its many operations. The machine acts independently in executing each of its instructions. In the course of executing a program involving perhaps thousands of steps, it accomplishes each without reference to the step it has just performed or the one it is about

to perform. Therefore, each computer step can be looked upon as an independent operation. This means that the versatile clerk analogy ignores specialization only in that the computer absorbs large volumes of information and retains control over these data until they have been processed. Internally, there is a real separation, one which could not be achieved by a person with respect to the individual steps.

In other words, at the instant a given step is taking place, only the process called for and the associated data it uses can impinge upon it (the process). This is true specialization since the measure of any departure therefrom is the availability of other data and a procedure needed to perform one or more additional steps.

The computer can make inadvertent errors because of the failure of its circuits to operate properly. However, there are devices and programing methods to deal with these errors. Such devices and program steps are in their effects much like the separation processes used in conventional systems.

The giving up of control based upon conventional clerical specialization is probably the most conspicuous change in the external manifestation of internal control resulting from the use of electronic data processing. As the computer system embraces larger segments of activity, control of the planner increases, thereby shifting the focus of the problem from processors to planners.

Organization of clerical work—separation of paper work from physical processes. Acts like signing, mailing, depositing, and counting are referred to here as physical processes. They are activities which in good systems of internal control are kept separate from associated data processing. As a class they usually involve contact with assets, either in physical handling, or in directing use, as in the case of access to funds.

When activities of this kind are performed on a physical object (including money), the presence of an automatic paper work system will not affect that aspect of internal control which is based upon separation.⁹

When the object worked on is paper, including checks, we must recognize that it is possible to incorporate associated processes into an automated system. This means that part of another class of control is submerged into the operation of a computer.

⁹ However, it is dangerous to be unequivocal in making any of these observations, since there are transaction-recording developments going on which link physical processes and source-data recording.

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The following quotation illustrates this point. "In this particular installation more payroll checks are processed than in any other; . . . the checks are printed, automatically signed, and automatically stuffed and sealed in envelopes in a matter of minutes—for distribution to employees—without human inspection."¹⁰ The rationale for abandoning the principle of separation here is found once again in the impersonal attitude of the computer. Barring error caused by deliberate manipulation of programs, which would be dealt with by other means, and given proof that controls exist over input, including changes to the employee master file, there is a presumption that the output is good. The final review implied by affixing signatures to checks manually is not as important a measure of control as it is in systems which give people participation at almost every step of the process.

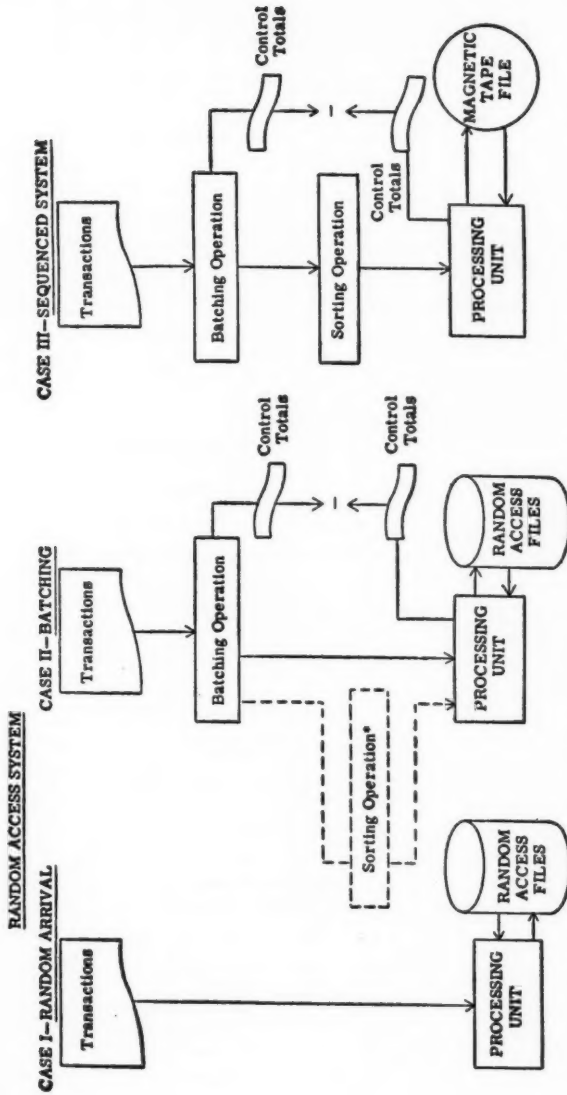
Conclusions

Normally, it is one thing to install internal controls and another to establish that they are operating. The insertion of such controls in an electronic data processing system is its own guaranty; barring malfunction, the system will not fail to exercise their use.

The automation of internal control via electronic data processing extends to some of the techniques which previously were always accomplished manually. This is particularly true of the validating or editing function, where the quality of data is concerned.

The electronic data processing system's powerful checking abilities make it a center of control. In this role it helps to police noncomputer operations. In effect, the automatic system checks itself and checks operations which preceded its own.

¹⁰ Pontius, James W., "Large and Medium Capacity Systems at General Electric," *AMA Special Report No. 22, Electronics in Action—The Current Practicality of Electronic Data Processing*, p. 80, 1957.



*This step is optional. It will permit faster processing through drum or disk-type random access files.

FIG. 1. RELATIONSHIP OF EQUIPMENT TO BATCHING CONSIDERATIONS

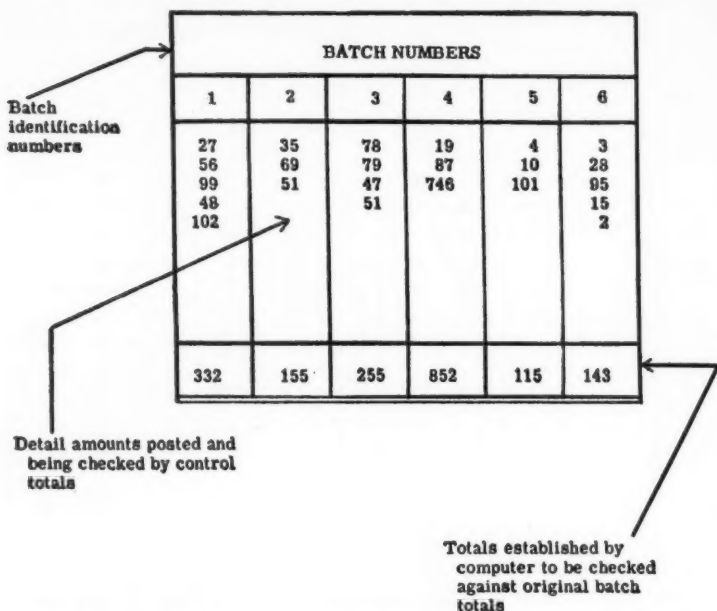


FIG. 2. COMPUTER-GENERATED CONTROL TOTALS—Suggested Format for Report Showing Results of Simultaneous Processing of Many Batches.

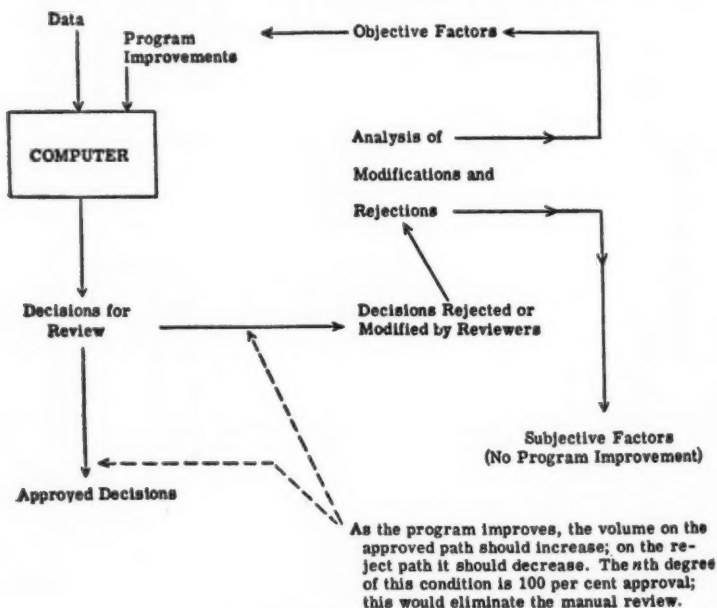


FIG. 3. IMPROVING DECISION CRITERIA

The Role of Statistics in Independent Audits of Financial Statements

By Thomas J. Cogan

Foreword

The following article is based upon a panel discussion before a group composed of both accountants and statisticians. Its purpose was to present, by way of contrast with other discussions, some of the especial problems of applying statistical techniques to the complex of individual audit procedures which on an overall basis, comprise a financial statement examination. It should be considered in this context and not necessarily to represent a viewpoint of the author that the application of these procedures is impracticable or undesirable.

* * * * *

The possibility of use of statistical sampling techniques by independent accountants as part of their examination of financial statements has obvious appeal. Testing of selected transactions as a means of drawing conclusions is an important phase of these examinations. Since statistical sampling techniques also use partial data for purpose of drawing conclusions in nonaccounting areas, it seems reasonable to assume that the appeal stems from parallelism of objective. While statistical techniques have not, as far as I know, been extensively used in practice in the accounting and auditing areas, intensive experimentation has been going on with regard to their possible applicability. Of course, an obvious advantage of statistical techniques is that they enable evaluation on an objective basis—or quantification—of results of tests. This, in turn, facilitates determination of sample sizes. I personally also believe that, in addition to this obvious advantage, there is another one which, while less apparent, is perhaps even more important. This is the need which they prescribe in order to apply them, to carefully define the objectives of a test. The auditor must decide what he is setting out to determine and where the purpose of the test fits into his over-all examination in order for a decision to be made as to a proper sampling plan.

While anything said currently will, perforce, be far from being the last word as to the role that statistical techniques may occupy in audits, I should like nonetheless to attempt some appraisal of their possible use, even if nothing more is gained than simply to give some direction to where further experimentation and consideration may profitably go.

In order to do this, it is necessary to consider the objectives of audit tests. A prerequisite to this is to consider just what an audit is. At the risk of making statements which may appear to be elementary, let me define briefly an audit as I view it. It may, I believe, be fairly defined as an independent and impartial review of a company's accounting determinations. Its most general use is for the purpose of expressing an opinion on the company's financial statements as to (a) the bona fides of accounting determinations of the aggregate of individual transactions comprising the account balances, which in turn, make up the financial statements, (b) the conformity of the results of those determinations with generally accepted accounting principles, and (c) the resultant fairness of presentation of financial position and results of operations. Of course, audits may also be made for special purposes such as those leading to reports upon compliance by companies with bond indenture provisions, and investigations for the purpose of discovering possible existence of fraud or for determining the extent of discovered fraud. However, for purpose of this discussion, audits, and the use of tests as part of them, will be considered solely as related to financial statement examinations.

It must be borne in mind that sampling or testing of transactions is not the sole means by which an auditor arrives at his opinion upon a company's financial statements. Among other things, he considers the structure of the company's accounting system and internal control. On the basis of his experience and

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professional proficiency, he considers the reasonableness of the relationship to each other of specific accounts. Comparison with financial results of prior periods is also significant. In doing this in all likelihood he considers the influence upon the company's financial results which may be expected of changing economic trends. Thus a change in profitability which conforms with the trend would be considered as reasonable, whereas a contrary change would indicate the need for considerable investigation and inquiry. He, of course, to some extent needs to take into consideration the quality of personnel of the subject company. He must also consider the extent to which business or tax considerations may introduce bias into accounting determinations. For example, a company experiencing large profits and subject to high income taxes may be inclined to expense items which more properly are capitalizable. On the other hand if the company were in an unprofitable period, the auditor would especially scrutinize capitalized items for those which possibly should be charged to expense.

In addition to tests of transactions being but one of several steps brought to bear upon the auditor's work in formulating an opinion on financial statements, he must also consider, in endeavoring to arrive at a conclusion as to the possible applicability of statistical sampling techniques, that many audit steps are interrelated. Individual accounts must be viewed as being interwoven into the over-all structure of a company's accounting system. To illustrate this by way of an analogy, an individual account may be said to have somewhat the same relationship to the over-all body of accounts that a thread has to a piece of cloth. For example, the receipt of a check very obviously affects the cash account. However, it will also affect another account, let us say accounts receivable in the case of a customer's remittance. Because of this interrelationship, audit steps are to a large extent cross-corroborative. Thus in verifying one account, the auditor, at the same time, gets some satisfaction with regard to another related account.

Another point which must be borne in mind is the primary objective of a particular test. In recent years, accountants have relied increasingly upon their over-all evaluation of a company's system of internal control and check as a means for forming an opinion upon the validity of its financial representations. This has given rise to an endeavor to draw distinctions between tests

which are procedural in nature vs. those which have as their primary objective the determination of bona fides. In view of the complex of auditing procedures which are employed in arriving at an opinion upon financial statements, and since many audit procedures are corroborated by or are corroborative of other procedures, it is, as a practical matter, difficult to draw this distinction clearly and in a useful manner. To the extent that a test is considered primarily procedural in nature, it generally has been the practice to make it more intensive and less extensive than those which are aimed primarily at determination of bona fides.

At present, use of available statistical techniques appears to be most indicated in dealing with tests of voluminous and homogeneous items and where corroborative interrelated procedures are viewed to be comparatively insubstantial. To the extent that individual tests have basically one objective and are not affected by other tests, the usefulness of statistical techniques can probably be decided upon with relative ease. However, as I said, auditors frequently perform many of their procedures in such a way that a number of examination steps are interrelated. Since, in these cases the final conclusion about a particular area of the accounts is not drawn solely upon the basis of one test or sample, statistical evaluation of the adequacy of that one test may not be especially meaningful. Further experimentation may uncover ways of dealing with this interrelationship and with other complications such as the fact that some satisfaction about internal control and reliability of the records may be gained by systematic reviews and by procedures other than tests of transactions, but just how these individual conclusions resulting from various audit procedures may be combined statistically or mathematically is not yet clear—to me in any event.

After these general remarks on the possible applicability of statistical sampling techniques in financial statement auditing let me go briefly into specifics.

Requirements of Randomness

First, I should like to touch briefly on the subject of randomness as it affects the selection of items to be tested by an auditor. One requirement for a test or sample which is to be subjected to evaluation by statistical techniques is that it be randomly drawn, that is, that it be designed so that every item in the population

has an equal chance of being chosen as an item to be tested. Randomness is essential since statistical sampling rests upon the foundation of probability theory. Further, selection of items on a subjective basis may, in all likelihood, introduce a bias, the effect of which would not be susceptible of estimation. Also, to the extent that such subjective bias would result in the purposeful exclusion of certain items from the test, no statistical conclusion could be drawn as to such excluded items. Now "Generally Accepted Auditing Standards," in discussing tests, states that "The appropriate degree of testing will be that which may reasonably be relied upon to bring to light errors in about the same proportion as they would exist in the whole of the record being tested." If this specification were to be rigorously adhered to, it appears to be obvious that selection of items to be tested should be drawn in a fashion which would be satisfactory to a statistician for his purposes. Now we know that in practice this is not quite so. For example, we may decide to test vouchers covering a single week or a single month of the year rather than scattering our tests throughout the year. This may be designated as "block sampling." Further even when we do not sample en bloc, items may be selected on some purely judgmental basis. For example, in examining expense charges especial attention may be given to travel and entertainment expenses—attention out of all proportion to the relative number and dollar amount of such items. Now the question is, do auditors, when they depart from random selection, engage in substandard practice. In the face of the statement in "Generally Accepted Auditing Standards," it might appear, at first look, that they do. However, I think that this single statement must, like all other statements, be viewed in the light of context, and context here, I believe, is the entire body of authoritative literature which furnishes guidance on what constitutes "Generally Accepted Auditing Standards," rather than a single statement in any one document, regardless of its stature. The question, like most questions worth raising, does not relate to a simple matter. Let me at this point repeat for emphasis that any one audit test is simply part of a complex of auditing procedures which are brought to bear upon the auditor's formulation of his professional opinion upon a company's over-all financial statements. Testing en bloc or testing by means of judicious selection that has no apparent pattern but which largely rests upon the auditor's intuitive judgment, formed as he proceeds with his

work, I believe, yields useful information. Parenthetically, let me say that I am quite ready to concede that block tests can yield statistically valid conclusions only with respect to the period tested, and I suggest to the profession for its consideration that where block tests are believed to be useful—this limitation being appreciated—that the selected week or month be subjected, not to 100% examination, but to a statistically chosen and evaluated test of transactions in that month. I also am willing to concede that it is quite unlikely that any statistically valid conclusion can be drawn where items to be tested are selected by judgment. Nonetheless as I said, I think that tests of this nature serve a useful function. To say that an auditor should not test at all unless his tests are designed to meet requirements of statistical techniques, I think would reduce rather than enhance the status of present day auditing procedures. In my opinion, little is to be gained by circumscribing the flexibility with which the auditor may exercise his professional judgment.

Extent of Tests

Consideration of tests which, by reason of their manner of selection, may be said not to meet statistical specification brings up the question of the extent of audit tests. Some concern has been expressed on the part of the profession about the fact that some tests made by reason of the small number of items selected, may not be sufficient for purpose of arriving at any reasonable and valid statistical conclusions. I think that this fear is to a large part unfounded. I think also that it may largely have arisen because thinking has centered around confidence levels of 95% or more. When we consider that a particular audit test in most instances is corroborated by other audit procedures it may very well be that a lower confidence level—say 68% or 80%—is satisfactory. As compared with a 95% confidence level, and using rough numbers, use of an 80% level would call for only about half as many items to be tested and a 68% level for only about one-third as many items.

Perhaps another cause of concern may be that many who have looked into this subject, in considering whether or not a particular audit test affords a respectable answer statistically, have sub-consciously viewed evaluation in terms of estimation sampling plans. It may very well be that in many cases the auditor is willing, and wishes in fact, not to ascertain an estimated propor-

tion of error which exists in a given field but simply to obtain a given assurance that if error of a particular type exists, his tests will turn up at least one. Under these circumstances, he would turn not to an estimation sampling plan but rather to the discovery or exploratory sampling plan technique. It may be of some interest to note that while this last technique has not been greatly dealt with in current literature, it was as far as I know, the first statistical technique to be brought to the attention of accountants as being of possible use. This was back in 1933 in an article by Lewis A. Carman, a California CPA.

Another factor which cannot be ignored is the influence upon the reliability of a sample which results from the circumstance that audits usually are made for successive periods. Assuming that conditions are unchanged during successive audits, a sample size which in one examination would give a confidence level of 68% would, when coupled with a like test in the following year's examination, yield a confidence level of 90%, and if again repeated in a third year, the cumulative confidence level would be 97%. Now I will readily admit that because of the assumption I made as to unchanged conditions perhaps the validity of this conclusion is somewhat weakened, but nonetheless one cannot deny that the effect of successive examinations does have considerable influence upon the reliability of what is drawn from a sample.

Conclusion

To summarize, I believe that statistical sampling techniques offer a very promising possible tool for use in examination of financial statements. Further, I believe that their use is most indicated in areas of large volume, containing relatively homogeneous items and where audit verification rests primarily upon the particular test. Third, I think in our consideration of this matter, careful thought should be given to the type of sampling plan most appropriate for use in various areas and for particular objectives and also to what might be considered acceptable confidence levels.

Inventory Control Methods Which Eliminate Duplicate Records and Annual Inventories

By John J. O'Donnell, Jr.

Scientific inventory control has become a by-word of today's business managers. Rising interest rates coupled with increased production costs have prompted businessmen to apply modern techniques to controlling inventory levels. As a result of the application of these scientific methods, inventory record keeping has become more complex and costly.

The purpose of this paper is twofold: first, to demonstrate how management information requirements can be met without a duplication of inventory record keeping; and second, to present the method of cyclical inventory as a substitute for an annual physical inventory.

The subject of inventory record keeping will cover:

1. Production Control and Accounting requirements for inventory record keeping.
2. The locations and content of inventory records.
3. Inventory record keeping in Company A (an example).
4. How one detail inventory record can be designed to satisfy the requirements of both production control and accounting.
5. How the amount of work involved in detail inventory record keeping can be minimized.

The subject of physical inventories will cover the requirements of a cyclical inventory system and conclude with a description of the cycle count procedure instituted by Company A (an example).

Requirements for inventory record keeping: In the average industrial company we generally find three types or classes of inventory:

1. Raw or purchased parts
2. Work in process
3. Finished product.

Both Production Control and Accounting have information requirements relative to each of these classes of inventory. Accounting values inventories, production works with the inventories. Accounting records the activity of each class of inventory in dollars. Production Control requires an up to date record of

the actual quantity of each item of inventory on hand, on order or in process. Generally, we can say that accounting requirements will be met if it has the means of developing *summary* dollar amounts of each class of inventory. On the other hand, Production Control's information requirements will be met if it has a *detail* quantity record of each item of inventory.

Location of Inventory Records: With the general requirements of Production and Accounting in mind, consider where detail perpetual inventory records might be found in the average company.

1. PRODUCTION CONTROL:

a. *Raw and Purchased Parts:* We may find a perpetual inventory record of raw and purchased parts either in the Production Control office or in the storeroom, or perhaps in both places. This record may show requirements, on order positions, receipts, issues, on hand balances and perhaps available and allocated stock. The detail record of each item may be kept in quantity only, or may also include dollars.

b. *In Process:* We may find some type of paper-work control over the in-process inventory. This could be accomplished through the use of a centralized dispatching system. The dispatchers' file or crib would contain production tickets representing all items presently in process. These production tickets would indicate quantity to be produced, the quantity produced thus far, the last operation performed and perhaps the number of labor hours expended for each operation.

c. *Finished Product:* Again, either in the Production Control office, in shipping or the finished storeroom we may find a perpetual inventory record of the finished product. This record might show the amount received into the storeroom, the amount shipped and the balance on hand.

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2. PURCHASING:

If the purchasing department is not under the control of the Production Control Department, or if it is not physically located near the raw and purchased parts inventory record, we may find a detail perpetual inventory record maintained in purchasing which would be quite similar to the raw and purchased parts record maintained in Production Control.

3. ACCOUNTING:

In accounting we may find the same degree of perpetual inventory record keeping over raw and purchased parts, work in process and finished stock as we did in production. But in addition, we would find that each of these records would indicate unit cost and dollar value in addition to quantities.

4. SALES:

In the Sales Department we may find a detail record of finished goods inventory. This record might be used as a convenient reference file for handling customers' inquiries.

To demonstrate a method of reducing this type of duplicate perpetual inventory record keeping, let us examine the record keeping involved in the *purchased parts inventory* of Company A.

Inventory Record Keeping in Company A: Company A produces valves, in various sizes, for commercial water pipelines, and industrial oil refining operations. There are some 10,000 component parts which are purchased. The main process operation is the assembling of these component parts into subassemblies and finally into the finished valves. There is a minor amount of prefabrication and the parts prefabricated are included in the purchased parts inventory. The majority of valves are made for stock. Perpetual inventories records of *purchased parts* are kept by Production Control, Purchasing and Accounting.

1. PRODUCTION CONTROL:

The detail perpetual records maintained in Production Control are in quantity only. These records indicate, for each item, the forecast requirements based on periodic production releases of end product requirements. On-order positions are posted to these records, as well as receipts, issues and on-hand balances. Reorder points and economic order quantities have been established for each item in the purchased parts inventory.

2. PURCHASING:

The detail perpetual records maintained in purchasing show on-order positions, receipts, issues and on-hand balances.

3. ACCOUNTING:

The detail perpetual records maintained in Accounting include:

- a. receipts in quantity, the average unit cost and total invoice amount,

Inventory Control Methods

b. issues in quantity, the average unit cost, and extended dollar value, and

c. on-hand balances in quantities, average unit cost and dollar value.

Purchasing: The duplication of record keeping between Production Control and Purchasing is obvious. The purchasing inventory record could be eliminated by instituting the following revised procedure. The control over reordering and the determination of the quantity to be ordered could be established by Purchasing and Production Control periodically. The reorder points and economic order quantities would be entered on the inventory records kept in Production Control. The Production Control Department would issue a purchase requisition to Purchasing whenever an item of stock reached the predetermined reorder point. The economic order quantity would be entered on the requisition. Upon receipt of the purchase requisition, Purchasing would obtain quotations, place firm purchase orders and follow up on deliveries. Under this type of system there is no need for Purchasing to perform the additional function of inventory record keeping.

Accounting: Company A uses an actual cost accounting system. The actual cost of each item received is recorded and an average unit cost developed. The average unit cost is used for costing requisitions for parts used in assembly.

For example, the perpetual inventory record maintained by Company A's Accounting Department shows for item #157, the 4" jackets (Exhibit #1):

1. Two receipts during October. On October 3, 100 units were received and invoiced at a unit price of \$19.00 each or \$1,900.00. The 50 units received on October 15 cost \$20.00 each or \$1,000.00.

2. Issues or requisitions in varying quantities during October are priced out at the September 30 computed average actual cost of \$19.25.

3. On October 31, a new average actual cost is computed at \$19.30. This cost will be used to price out November requisitions.

The main purpose this detail record serves is to provide an average unit cost to be applied to each item charged into production.

One Perpetual Inventory Record: Now if a standard unit cost can be developed for each item purchased and subsequently requisitioned into production, we have the opportunity of eliminating the detail perpetual record maintained in Accounting. The application of standard cost accounting techniques to the purchased parts inventory would work as follows:

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1. Standard unit cost would be computed and determined annually for each item of stock. These standards would be based upon the current invoice price of each item, adjusted for any known future increases or decreases. The initial responsibility for computing such standards would rest with purchasing. Standard unit costs would be revised annually or whenever major price changes are experienced.

2. Detail perpetual inventory records in quantity only would continue to be maintained in Production Control.

3. As materials are received the quantities would be posted by Production Control to the appropriate item cards in the perpetual inventory record. The receiving report would be matched with an invoice received in Accounting. Accounting would extend the quantity received and invoiced at the predetermined unit standard cost and compute a purchase price variance. For example (Exhibit No. 2):

If 100 valve jackets were purchased and received, 100 units would be added to the on-hand balance on the perpetual inventory record maintained by Production Control. The 100 units appearing on the invoice would be extended by Accounting at the predetermined unit standard cost of \$20.00. The resulting \$2,000.00 standard cost would be subtracted from the amount actually charged by the vendor. If the amount actually charged was \$19.00 per unit a difference representing a purchase price variance of \$100.00 would result. For accounting purposes the \$100.00 price variance would be credited to a variance account, \$2,000.00 would be charged to the purchase parts inventory and \$1,900.00 recorded as a liability to the vendor.

4. As units required on a bill of material for a valve are requisitioned from stores, the quantity appearing on the requisition would be deducted from the detail perpetual inventory record maintained in Production Control. The requisition forwarded to Accounting where it would be extended by the unit standard cost previously developed for that item. The resulting standard cost of the quantity issued to Production would be subtracted from the dollar control balance in the purchased parts inventory account. Continuing with the example of the valve jackets, if 50 jackets were released or issued to production the quantity of 50 appearing on the requisition would be deducted from the balance of jackets on hand as shown by the perpetual inventory record. The requisition would then be forwarded to Accounting where the 50 units would be extended by the unit standard cost of \$20.00 and \$1,000.00 deducted from the purchase parts inventory account.

5. Periodically, perhaps once or twice a year, the on-hand quantity balances on the detail perpetual inventory record in Production Control would be extended by the unit standard cost of each item in inventory. The resulting total value at standard cost of the items in inventory would be compared with the accounting general ledger control account balance. Provided there is proper control over the processing and recording of receipts, invoices and requisitions, the total extended values of the detail inventory records should agree with the control account on the books (after an adjustment is made for items received but not invoiced).

This comparatively simple system of using predetermined standards instead of average actual costs results in the elimination of the detail perpetual inventory previously maintained by Accounting and has highlighted for management purposes the variance between what they planned to pay for items of inventory and what they actually had to pay. Provided this difference or variance is not a significant amount, no adjustment need be made to the inventory in dollars reported for financial statement purposes.

Minimization of Record Keeping: So far, we have seen how we can reduce detail inventory record keeping to one record maintained by Production Control by eliminating the requirement for Purchasing and Accounting to maintain similar records. But we should proceed one step further. The extent to which Production Control maintains a record of each item of inventory might also be challenged. Techniques can be applied which will point out the opportunity of decreasing the amount of clerical effort involved in this inventory record keeping. The extent to which refined records are kept of each item depends upon the dollar usage of the item. Low dollar usage items need not be exposed to the same degree of record control as are high dollar usage items. For example, an inventory study and analysis of the dollar usage of the 10,000 purchased parts stocked by Company A might disclose that the inventory could be divided into three classifications (Exhibit #3):

1. High dollar usage items for which we would require scientific inventory analysis such as forecasting and monthly determination of reorder points and economic order quantities. In addition, receipts, issues and on-hand balances would be posted to the perpetual records.
2. Lower dollar usage items for which minimum and maximum on-hand requirements might be determined only once a year and for which the extent of inventory record keeping would be limited to recording receipts, issues, on-hand and on-order balances.
3. Low value items for which we may not require any formal day to day perpetual inventory records and for which reorder points would be set by segregating or packaging minimum quantities for safety stock in one section of each bin. Items falling into this category may be valued at a base or fixed stock amount. Under such a base stock inventory the cost of items purchased during the year would be charged to expense and a physical inventory taken of such items at the end of the year for purposes of adjusting the base stock to the inventory value at the end of the year.

The application of this analysis to our example may result in the following configuration of our total of 10,000 items: 2,000

may fall into the high dollar value category which would represent 75% of the dollar inventory and these items would be scientifically controlled. 3,000 of our items representing 20% of the inventory in dollars would be subjected to minimum maximum control and 5,000 items representing 5% of our inventory would not require detail perpetual inventory records.

With this reduction in inventory record keeping through the elimination of duplicate records and the minimization of the clerical cost and effort involved in maintaining the one perpetual inventory in Production Control, we have a good basis for instituting cycle count procedures which will eventually eliminate the need for taking an annual physical inventory.

CYCLE COUNTING PROCEDURES

Definition: Cycle counting may best be described as a continuous inventory count. The method requires a perpetual inventory record of each item included in the controlled inventory. Physical counts are planned and scheduled during the year in such a manner that all inventory items will be counted at least once during the year.

Advantages: Some of the benefits which companies have realized through the adoption of the cyclical method of inventory verification center around the elimination of undesirable conditions normally associated with an annual physical inventory such as:

- a. Suspension of plant operation and the interruption of production schedules.
- b. Interruption of normal office routine by imposing heavy work loads and overtime in the office for pricing, extending and adding the physical inventory worksheets.
- c. Extended periods of overtime required for rearranging stock, counting and investigating differences between the physical counts and the inventory records.

Industries using cycle count procedures develop specialists in inventory taking. Counting is accurate and efficient as these counters become more and more familiar with the stock. Damaged, defective and obsolete stock is brought to the attention of management promptly.

Some Basic Requirements of a Continuous Inventory System:

1. Detail perpetual inventory records must be maintained. These perpetual inventory records must be posted promptly and accurately. It is desirable that there be only one detail perpetual inventory record and that

Inventory Control Methods

that record be maintained in Production Control on a when received and when issued basis.

2. There must be a good control procedure over paper flow. Receiving reports must be made out promptly and routed directly to Production Control and Accounting. Requisitions should be prepared for all issues from stores, forwarded promptly to the inventory record keepers and subsequently to Accounting. It is essential that a numerical control over receiving and requisitioning be instituted through the use of prenumbered forms.

3. Good physical arrangement of stock is necessary. If possible all quantities of each item should be stored in one section. Up to date location records are also desirable.

4. Counts should be scheduled in advance. There are various methods of planning cycle counts. For example:

The year may be divided into count periods. A week may then become a count period. Inventory items would be assigned to count period, in such a manner that all items will be counted at least once a year. Another method used for scheduling counts is to count the item of stock when it reaches its reorder point. One advantage of this method is that the quantity of the item to be counted should be at a low point, thereby making the counting job much easier. A deterrent from using this method is that some items may be counted many times during the year, thereby increasing the physical and clerical labor cost involved in performing the counts.

5. Good cutoff procedures must be developed. This cutoff should be obtained without suspending operations. Some of the prerequisites I have already mentioned, if employed, will help to minimize this problem of cutoff. (For example, keeping the inventory records up to date and accurate and providing for good flow of paper between units.) Some companies make their counts just before the end of a shift; others take the count during the day and make a record of the most recent receipts of merchandise or stock and the most recent requisitions. An interesting technique employed by one company was to have the counts made between midnight and 8 o'clock in the morning during which time there was no production.

6. The men designated to perform counts and reconcile differences should be independent of the storekeeping and record keeping functions. For example, the cycle counters can report directly to the Production Control manager or the controller or can be attached to the Internal Audit Department.

Example of Cycle Count Procedures: In our valve company with 10,000 different items of purchased parts inventory we can apply cycle count procedures to the high dollar value and lower dollar value items. The first step would be to:

Plan Counts: Our policy might be to count the 2,000 high dollar value items twice a year and to count the 3,000 lower dollar value items once a year. Prior to the beginning of the year a day by day count schedule would be developed. Based on a quantity of 7,000 counts during the year, one man could average 35 to 40 counts a day. Our count schedule would be set up to show (Exhibit #4):

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The items to be counted each day are in consecutive number sequence. Using a shop calendar, we would show for example, on our high dollar value items that items number 100 to 125 be counted on day 1 and day 120. Also on day 1 our schedule would indicate that lower dollar value items number 3,000 to 3,012 would be scheduled. If a schedule in item number sequence is not practicable perhaps the schedule could be set up in location number sequence. In any event it is very desirable to have the sequence of items appearing on the count schedule correspond to the sequence in which the same items appear on a detail perpetual inventory record.

Prepare Count Cards: Prior to the count day, inventory count cards would be prepared. The count card would contain the following data (Exhibit #5):

1. Item number and description of the part to be counted.
2. Location of the item.
3. Date of the count showing both the calendar date and the shop calendar day.
4. The count tickets or cards should be prenumbered and issued in sequence.
5. Cutoff data relative to the last receiver and the last requisition. For the last receiver we should indicate the number of the receiving report, the vendor from whom the material was received and the quantity received. For the last requisition we would insert the date requisitioned, the requisition number, production order number on which the item is to be used and the quantity used.
6. Count quantity and the initial or name of the person making the count.
7. Record quantity and the name or initial of the person entering the quantity from the inventory record and reconciling the difference.
8. The difference and an explanation of such difference.
9. The standard unit cost of the item.
10. Dollar adjustment necessary on the accounting record to reflect the inventory difference.
11. Approvals, perhaps by the production manager, and an indication that the adjustment has been made to the inventory record and to the accounting records.

At 4 o'clock in the afternoon of the count day, the counter would receive the count tickets and enter on each of them the data relative to the last receiver and the last requisition. The receivers and requisition for the day remain in the Production Control office until 9:00 a.m. on the day following the count, thereby enabling the counter to record this cutoff data. At 9 a.m. the following day the receivers and requisitions would be passed on to Accounting.

The counter would then start the count. As Company A operates only one shift, the counter would be making his counts

after the end of the shift at which time there would be no activity in receiving or requisitioning materials.

On the morning after the count a clerk in the Internal Audit Department receives the count cards and performs the following steps:

1. Accounts for the sequence of numbers on the count tickets and notes on the count planning schedule that the counts have been made.
2. Records the balance on hand appearing on the detail perpetual inventory record after all receivers and requisitions for the previous day have been posted.
3. Computes the difference, if any, between the count quantity and the record quantity. If the difference is in excess of 2% of the record quantity balance, an investigation would be made into the reason for such difference and the explanation and action taken so noted on a count card.
4. The standard unit cost would be inserted on the count card and the dollar adjustment computed.
5. Required approvals would be obtained and adjustments made to the inventory records.
6. An adding machine tape listing of the dollar adjustments for the count day would be taken and attached to the batch of count cards forwarded to the Accounting Department for adjustment.
7. A daily report would be issued to the Production Control manager and the controller indicating the total net dollar adjustment for the day and cumulative net adjustment to date.

Adequate cycle count procedures tied in with a perpetual inventory system eliminate the need for an annual physical inventory and are acceptable to the certified public accountant. However, the CPA will apply standard auditing techniques to test the adequacy of the procedures. A review of the procedures for inventory record keeping and cycle counting will be made by him. In addition, a sampling of the inventory items will be selected, physical counts made and compared to the inventory records. A review will also be made of the coverage of items included in the cycle count procedures and the amounts of the adjustments made where differences were found.

In summary, inventory methods can be developed which will reduce the number of inventory records and eliminate duplicate record keeping. Generally, this can be accomplished by setting up a perpetual inventory record under the direction of Production Control and applying standard cost accounting techniques to satisfy the requirements of accounting. Annual physical inventory can be eliminated by instituting cycle count procedures tied in with a detail perpetual inventory system.

Exhibit #1

PERPETUAL INVENTORY RECORD
ACCOUNTING
(ACTUAL COST)

#160 2" STEM									
#158 5" JACKET									
#157 4" JACKET									
RECEIPTS			ISSUES			BALANCE			
DATE	QTY.	UNIT	\$	DATE	QTY.	UNIT	\$	DATE	QTY.
10/3	100	19.-	1900.-	10/1	50	19 ²⁵	962.50	9/30	100
10/15	50	20.-	1000.-	10/5	20	19 ²⁵	385.-		19 ²⁵
				10/10	10	19 ²⁵	192.50		1925.-
				10/28	30	19 ²⁵	577.50		
	150		2900.-		110		2117.50	10/31	140
									19 ³⁰
									2707.50

Exhibit #2

INVENTORY RECORD KEEPING STANDARD COST

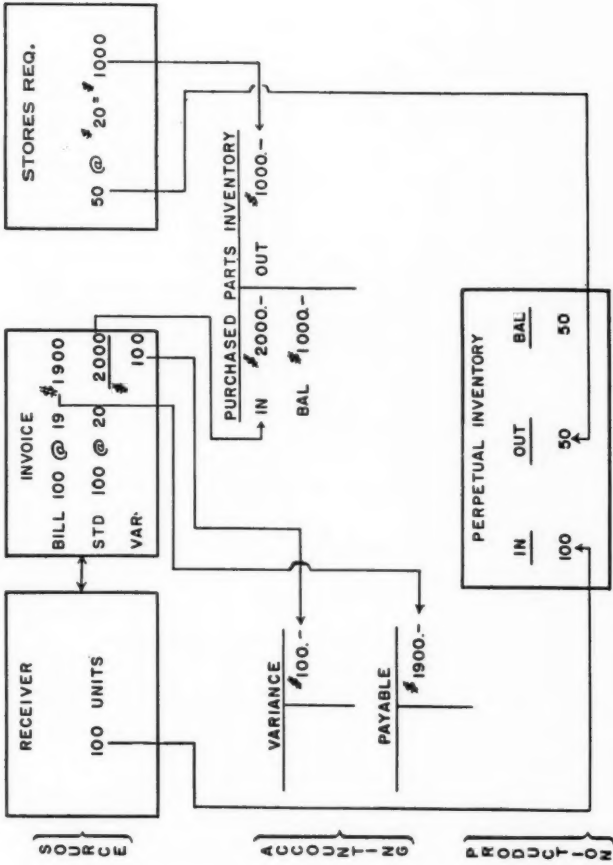


Exhibit #3

INVENTORY ANALYSIS

<i>Usage</i>	<i>Items</i>	<i>Inventory Value</i>	
		<i>\$</i>	<i>%</i>
High.....	2,000	\$ 750,000.00	75%
Medium.....	3,000	200,000.00	20%
Low.....	5,000	50,000.00	5%
	10,000	\$1,000,000.00	100%

Exhibit #4

CYCLICAL COUNT SCHEDULE

HIGH

<i>Item #</i>		<i>Count Day</i>	
<i>From</i>	<i>To</i>	<i>First</i>	<i>Second</i>
100	125	1	120
126	150	2	121
151	180	3	122
Etc.			

MEDIUM

3,000	3,012	1
3,013	3,030	2
3,031	3,050	3

CYCLE COUNT CARD

ITEM # 157	DESCRIPTION 4" JACKET		LOC A-32	DAY 1/4 3	1446
LAST RECEIVER		LAST REQUISITION			
DATE 12/29	NO. 5049	FROM B. CORP.	QTY. 50	DATE 1/2	NO. 1063
				FOR P O. #19	QTY. 20
COUNT QTY.		COUNTED BY J. JAMES			
RECORD QTY.		RECONCILED BY A. BEHN			
DIFFERENCE		EXPLANATION 3-SPOILED IN NOV.			
STD. UNIT COST		EXCESS STORES REQ. NOT POSTED TO RECORD.			
¢ ADJUSTMENT		1-UNACCOUNTED FOR			
APPROVED R. A. JONES	INV. REC. SMITH	ADJUSTED ACCOUNTING DOE			

Tax Accounting for Oil Income and Deductions During Periods of Litigation and Dispute

By G. W. Welsch

Scope of Subject Matter

There are three basic questions to be answered in connection with this subject:

1. To whom should the income be taxed?
2. Who is entitled to the deductions for intangible drilling and development costs, depletion, depreciation, operating expenses, etc?
3. When and how should the income and deductions be reported?

To answer these questions it is necessary to examine a number of cases and two sections of the Internal Revenue Code.¹ Since the statutory enactments were intended to alleviate hardships caused by judicial interpretations of the law, it appears logical first to review the case law and then to consider the relief intended to be provided by statute.

Claim of Right Doctrine

The foundation of most of the law relating to the time and manner of taxing disputed income is the "claim of right" doctrine, which finds support in the facilitation of the administration of the tax law.² In *National City Bank of N.Y. v. Helvering*³ Judge Learned Hand stated "It would be intolerable that the tax must be assessed against both the putative tortfeasor and the claimant; collection of the revenue cannot be delayed, nor should the Treasury be compelled to decide when a possessor's claims are without legal warrant. If he holds with claim of right, he should be taxable as an owner, regardless of any infirmity in his title; no other doctrine is practically possible . . ."

Although there was at least one earlier case⁴ in which the claim of right theory was advanced, the landmark case is *North American Oil Consolidated v. Burnet*.⁵ The facts in this case were as follows:

United States sued the company, which was operating on a section of Federal land. On February 2, 1916, a receiver was appointed to hold the net income from the property. In 1917, a District Court decided the suit in

Tax Accounting for Oil Income

favor of the company, and the receiver turned over the impounded funds. The Government appealed (without supersedeas). In 1920, the Circuit Court of Appeals affirmed the decree, and the Government appealed to the U. S. Supreme Court. In 1922, that appeal was dismissed by stipulation.

The only question in the tax case was the year in which the company was taxable on the earnings which were turned over to it by the receiver in 1917. The company claimed that it was taxable in either 1916, the year the oil was produced, or 1922, the year the controversy was finally settled. The Government maintained that the income was taxable in 1917, the year it was received by the company—an EPT year.

In deciding for the Government, the Supreme Court said:

"If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent . . . If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year . . ."
(Emphasis supplied.)

The last sentence quoted was not necessary to the decision because the Government did not prevail in 1922. However, this dictum was subsequently upheld in *U. S. v. Lewis*.⁶

The claim of right doctrine applies only where the funds received qualify as income.⁷ Whether income has in fact been received under a claim of right depends upon the particular facts of each case. The Courts have drawn distinctions based upon the facts of a particular case and thereby avoided the strict applica-

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tion of the doctrine;⁸ but the doctrine has been followed in cases too numerous to cite here.

Example of Application of Claim of Right Doctrine

The clearest way to explain the principles involved is by examples. Assume the following hypothetical situation:

In 1950, Mr. Farmer, erroneously believing he owns the minerals under his farm, executes an oil and gas lease to Careless Oil Company, retaining a $\frac{1}{4}$ royalty and receiving a \$5,000 lease bonus. In the same year the oil company drills a producing well. In 1951, Mr. Owner brings suit, claiming that he is the rightful owner of the minerals. A receiver is appointed on December 31, 1951, to receive the net runs for 1952 and subsequent years. In 1953, the case is decided by the Court.

Assume first that the Court upholds Mr. Farmer's claim; what would be the tax results?

Mr. Farmer, having received a lease bonus and royalties in 1950 and 1951, would have been taxable on this income as received, subject to depletion. No income or deductions would be reportable for 1952 because it was uncertain who was entitled to the profits. The royalties for 1952 and 1953 would be includible in Mr. Farmer's income tax return in 1953, when he received these funds under a claim of right.

The Careless Oil Company would capitalize the lease bonus.⁹ It would deduct 1950 and 1951 expenses as paid or incurred and report 1950 and 1951 income as received or accrued, depending upon its method of accounting. It would report no income or expenses for 1952; these amounts, together with 1953 income and expenses, would be reportable in 1953, at the termination of the receivership.

Mr. Owner, never having received or been entitled to either income or expense deductions, would not report anything in any year.

What would the results have been if the Court had decided in favor of Mr. Owner?

An adverse decision would have no effect on the income tax of any of the parties for the years 1950, 1951, and 1952. Both Mr. Farmer and the Careless Oil Company received the 1950 and 1951 income under a claim of right and were properly taxable on it, despite the fact that in 1951 Mr. Owner was contesting their right to it. No income was ever received or accruable with respect to 1952 operations, so none was reportable¹⁰ by any of the parties.

For 1953, however, the tax effects would be substantial. Mr. Farmer and the Careless Oil Company would be entitled to deductions in that year for the amounts received and reported as income in 1950 and 1951,¹¹ less the depletion allowed or allowable with respect thereto.¹² In addition, the Careless Oil Company would be allowed to deduct the adjusted basis of its now worthless lease.¹²

In 1953 Mr. Owner would receive all of the income for the years 1950, 1951, 1952, and 1953; under the Court decisions, it would all be taxable to him at that time.

The Treasury has never questioned the right of the successful litigant to a deduction for intangible drilling and development costs, operating expenses, etc., expended before he was held to be entitled to the property and the income previously produced therefrom. It would be contrary to our entire system of taxation to tax such recipient on more than he actually received.

Similarly, it appears doubtful that any Court would uphold a Treasury argument that the losing litigants should be taxed on the income received under a claim of right, but denied deductions attributable thereto.¹³ Thus, there has been no controversy with respect to deductions for intangible drilling and development costs, operating expenses, etc.; but, until the recent statutory enactments, one question was not completely resolved, viz.: Would the winning litigant be allowed depletion on the amount received? If so, would the "gross income" for the purpose of this computation be the reconstructed gross income actually produced or the net amount of the award?

Before 1950, it seemed well settled that the owner of an economic interest who received a monetary award representing the proceeds of oil and gas wrongfully extracted was entitled to percentage depletion¹⁴ based on actual gross income from the property, not the net amount received.¹⁵

Although, before 1950, the Fifth Circuit had denied depletion to a litigant receiving impounded oil runs, the case¹⁶ was not generally viewed as contra to this basic premise, because its facts could be distinguished. The taxpayer was an attorney who received his share of the impounded oil runs as his fee for his successful prosecution of the suit which resulted in the recovery of the funds. He had no interest in the property or money until the case was won, hence he was not entitled to depletion on oil runs before his ownership attached.

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In 1950, the Fifth Circuit decided *Parr v. Scofield*;¹⁷ the facts in that case were as follows:

In 1936, George B. Parr obtained an oil and gas lease which he transferred to a partnership with the oral understanding that he was to have a one-fourth interest in the net profits from the property. After production was obtained, the partnership disputed the existence of the agreement; and Parr sued. In 1944, Parr recovered his share of the net profits for the years 1940-1944.

The Court determined that, under the claim of right doctrine, Parr was taxable upon the entire amount received in the year 1944 when the funds were turned over to him, rather than during the period over which the income was earned. In so holding, the Court found that Parr's agreement for a share in the net profits did not make him either a coadventurer or a partner; but the opinion indicates that the decision would have been the same even if the findings had been to the contrary.

The disturbing portion of the decision in *Parr v. Scofield* was its holding that the amount "representing past profits earned by them before his interest in the property was established," was not depletable income to Parr. In support of this holding the Court cited *Massey v. Com'r*.¹⁸

Encouraged by this decision, the Government attempted to deny a depletion deduction to a successful litigant in a subsequent case.¹⁹ The Tax Court, in holding for the taxpayer, distinguished the *Massey* and *Parr* cases as follows:

The cases of *Parr v. Scofield* and *Massey v. Com'r*, relied upon herein by respondent present exceptional circumstances which take them outside the general rule. The *Massey* case involved the availability of percentage depletion to an attorney whose interest was acquired pursuant to a contingent fee contract only upon the successful termination of litigation and at a time when the property to which his interest attached was in the form of money. The *Parr* case, upon which respondent lays the greater stress, involved a situation where the taxpayer had conveyed his ownership to the gas and oil but succeeded in subsequent litigation against the grantees in establishing an equitable interest in the "net profit" resulting from the operation of the property. Neither of these cases involved the situation here present in which the owner of the oil and gas recovers an award from trespassers representing the proceeds of the oil and gas wrongfully taken and to which he was entitled by reason of an ownership or investment long antedating the litigation in which the award was given.

While it appears that the Tax Court arrived at the correct conclusion in this case, its attempt to distinguish the *Parr* case cannot be reconciled with *Burton-Sutton Oil Co.*,²⁰ where the Supreme Court held that a "net profits interest" retained by a trans-

feror of property represented an economic interest subject to depletion. If the Fifth Circuit determined that Parr had retained a "net profits interest" when he conveyed the property to the partnership, he should have been entitled to depletion when he recovered the funds due to him.²¹

*Answers to the Three Basic Questions, as Determined
by the Courts*

Without considering subsequently enacted relief statutes, let us answer the three questions which are the basis of this discussion:

1. *To whom should the income be taxed?*

Income is taxed to the party receiving it under a claim of right. Amounts held in receivership are not taxable to anyone until the controversy is settled.

2. *Who is entitled to the deductions for intangible drilling and development costs, depletion, depreciation, operating expenses, etc?*

Except for the doubt cast on depletion by *Parr v. Scofield*, supra, it appears well established that the party taxed on the income is allowed the offsetting deductions.

3. *When and how should the income and deductions be reported?*

Income is taxable to a cash basis taxpayer when he receives it, and to an accrual basis taxpayer when he becomes entitled to it. Deductions are allowed when paid or incurred, depending upon the taxpayer's method of accounting. An unsuccessful litigant can deduct amounts repaid to the successful litigant in either the year of repayment or the year in which he became obligated to make the payment, depending upon his method of accounting. Money held in receivership or escrow is taxable when such receivership or escrow terminates.

Hardships of the Claim of Right Doctrine

The Supreme Court has stated that "it is the essence of any system of taxation that it should produce revenue, ascertainable and payable to the Government at regular intervals."²² The claim of right doctrine accomplished this purpose, but it produced harsh results. Sections 1305²³ and 1341²⁴ have been added to the Internal Revenue Code to mitigate these hardships. Let us look at the evils these sections were intended to cure.

First, there was the uncertainty caused by *Parr v. Scofield* whether a successful litigant would be allowed to deduct depletion.

Second, although the Courts had constantly decided the point in favor of the taxpayer, there was no statutory authority for the proposition that income and deductions retained their original character in the hands of the successful litigant. Thus, there was

the constant threat that the Treasury might refuse to permit the reconstruction of gross income and attempt to compute depletion on the net amount received, or might attempt to deny deductions for intangible drilling costs, etc.

Third, a successful litigant was faced with the bunching of income in one year. When the taxpayer was an individual or trust, our system of progressive tax rates could impose substantial penalties when three or four years' income was received—and taxed—at one time. Although sometimes, because of the peculiar situation of an individual taxpayer, the taxation of income in the year of receipt produced favorable results, in the usual situation additional tax resulted.

Fourth, an unsuccessful litigant was taxed on money received under claim of right in the year of receipt and allowed a deduction in the year of repayment. Sometimes this deduction would result in little or no tax benefit; at other times the benefit might be greater than the previous tax paid. Other unrelated items of income and deduction would cause the marginal tax rates to vary in the years involved.

The Remedial Statutes

Section 1305, assuming that it is applicable (see discussion later in this article), effectively alleviates the first three hardships without depriving any taxpayer of any benefits which might have accrued under the case law. Section 1341 clearly corrects the remaining one.

The Senate Finance Committee Report²⁵ on Section 1305 states:

Under existing law, averaging of certain receipts, such as those from back pay and patent infringement, is permitted. However, in the case of a breach of contract or breach of fiduciary duty or relationship, the injured party may receive a judicial award for the loss of income which ordinarily would have been received over a period of years. Under present law, the taxpayer in this case is required to include the total award in gross income for the year in which the award was received. This may, and frequently does, result in a substantially higher tax than would be imposed if the taxpayer had received the equivalent income over the period in which the breach of contract or duty occurred.

Furthermore, the character of the income has sometimes been held to be changed by the fact of its lump sum receipt as an award from a breach of contract or duty. For example see *Parr v. Scofield* (D. C. Texas 1950) 89 F. Supp. 98 (aff'd. C. A. 5, 1950) certiorari denied March 26, 1951, where it was indicated that an award for breach of contract involving a failure to pay over oil royalties does not give rise to a percentage depletion deduction.

Tax Accounting for Oil Income

No Regulations have yet been proposed interpreting section 1305, but the Senate Report clearly demonstrates the Congressional intent as to the manner in which the section should be administered.

The application of section 1305 is as follows:

A taxpayer who receives an award representing a loss of income must make two tax computations. The first computation is to determine the tax that would have been due if there had been no litigation and the taxpayer had received the income as earned. The actual gross income and deductions from the property are used to make the spread back. The second computation is based upon including the amount received in the gross income for the current year. In this computation the taxpayer computes the percentage depletion deduction with reference to the reconstructed gross and taxable income from the property as if it were all attributable to that year.

The taxpayer thus determines, first, the tax he would have to pay if he had received the income when the oil or gas was produced and, second, the tax he would have to pay if it had all been produced in the year in which he received the award. Then he pays the lesser of these taxes.

Although the Senate Finance Committee Report states that "This bill restores the taxpayer to the position he would have been in had no breach of contract or breach of fiduciary relationship occurred," the statute in fact puts the taxpayer in a better position. He pays the lesser tax resulting from two computations. Under the statute, the tax attributable to including the award in gross income for the taxable year in which it is received cannot be greater than the aggregate increase in taxes which would have resulted if the taxpayer had received or accrued such award in prior years, but it can be less.

An individual may be in a substantially lower tax bracket in the year when he receives the award than he was in during the year or years when it was earned. Thus, he would pay the lesser tax resulting from the computation in which the oil and gas is treated as if it had been produced in the year when he received the award.

Even with a constant tax rate, as in the case of a corporation, better tax results might be obtained from treating all the income as earned in the year of receipt than from spreading it back. Assume the following income and expenses with respect to a property that is the subject of a controversy:

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<i>Year</i>	<i>Gross Income</i>	<i>Intangibles and Operating Expense</i>	<i>Net Income</i>
1956.....	\$100,000	\$100,000	\$ -0-
1957.....	200,000	50,000	150,000
1958.....	200,000	50,000	150,000
Total.....	\$500,000	\$200,000	\$300,000

Assume further that the taxpayer was awarded \$300,000 in 1958.

Using the spread back, the corporation would not receive any deduction for percentage depletion for 1956 because there was no taxable income from the property.²⁶ Percentage depletion deductions would be allowable in the amount of \$55,000 for each of the years 1957 and 1958, a total of \$110,000. Thus, using the spread back method, the taxpayer will pay a tax of 52% of \$190,000, or approximately \$100,000. On the other hand, if all the income and expenses were attributed to the year of receipt the allowable deduction for percentage depletion would be 27½% of \$500,000 or \$137,500 which is less than 50% of the net income of \$300,000. Thus, the tax would be 52% of \$162,500, or approximately \$85,000. Since the tax due would be \$15,000 less without the spread back, the corporation would compute its 1958 tax liability as if the relief provision had not been enacted.

Section 1305 does not apply unless the amount representing damages is \$3,000 or more.

Neither the statute nor the Committee Report mentions the treatment of interest or punitive damages. Presumably, these will be taxable in the year of receipt, and will not be subject to spread back treatment.

Section 1341 corrects the remaining hardship by preventing unjust taxation of the unsuccessful litigant. A taxpayer must compute, first, the amount by which the tax for prior years would have been reduced if the claim of right items had not been included in income, and, second, the reduction in tax which would result if the taxpayer were allowed to deduct the repayment currently.

Whichever method produces the lesser tax is used. The provisions of section 1341 are mandatory. In this connection other considerations, such as a possible accumulated earnings tax, per-

sonal holding company tax, the effect of other deductions, and the net operating loss carry-over and carry-back, must be taken into account.²⁷

If the taxpayer uses the spread back method, and the decrease in tax for prior years, resulting from the exclusion of the claim of right items, exceeds the tax (computed without the deduction) for the current year, the excess is considered to be an overpayment of tax for the current year. Thus, under section 1341 the tax can be no greater than it would have been if the claim of right item had never been included in income; it can be less. On the other hand, the taxpayer gets no interest for the prior year period during which the Government had the use of his money.

Section 1341 is of much broader application than section 1305. The Committee Reports show that section 1305 was enacted primarily with the oil industry in mind, but section 1341 was intended to alleviate hardship in numerous situations.

The Regulations under section 1341 make it clear that no new deduction is granted by that section by providing that the section applies only if "the taxpayer is entitled *under other provisions of the Internal Revenue Code* to a deduction of more than \$3,000 because of the restoration to another of an item which was included in the taxpayer's gross income for a prior taxable year under a claim of right"²⁸ (emphasis supplied). Thus, where a taxpayer under no legal obligation to do so voluntarily returns money to another, section 1341 would not entitle him to a deduction. For example, in a recent case, two brothers returned to their controlled corporation that portion of the rent paid to them in prior years which the Treasury had held to be excessive and therefore in the nature of a dividend. In refusing to allow an adjustment to prior years or a deduction in the current year, the Court stated that an obligation does not arise from a voluntary agreement to repay monies which a taxpayer would otherwise be entitled to retain. Absent such obligation, the deductions for repayment must be disallowed.²⁹ Although this case dealt with years before the enactment of section 1341, the result presumably would be the same under the statute.

The Regulations state that the words "restoration to another" mean restoration because "it was established . . . that the taxpayer did not have an unrestricted right to such item." It is not believed, however, that the use of the word "established" requires any stronger proof to sustain the deduction than existed prior to

the enactment of section 1341. The section was not intended to expand or contract existing rights to deductions; it was intended merely to provide relief from what might be unfortunate timing.³⁰

The amount to be excluded from income in prior years in determining the decrease in tax cannot exceed either (a) the amount included in gross income in such years, or (b) the deduction allowable on account of its restoration. Thus, in the case of oil and gas income, a taxpayer will be entitled to exclude only the amount returned less the depletion, since, as previously indicated, the deduction for the restoration is reduced by depletion previously allowed.

The Regulations make it plain that section 1341 applies to transferee situations such as that present in *Arrowsmith v. Com'r*.³¹

Assume that Careless Oil Company, in our first example, had dissolved and distributed its claim of right income to its stockholders in liquidation. These stockholders would have had to pay a capital gains tax for that year. If they were required to repay the income to Mr. Owner, they would be entitled only to a capital loss deduction, which might be wasted completely. Under section 1341, the stockholders would be entitled to recompute their tax as though the repayment reduced the capital gain previously realized.³²

The fact that the statute of limitations has run with respect to one or more years during which income had been received and reported under the claim of right doctrine does not prohibit the computations under section 1341. The Regulations specifically provide that no other item shall be considered in computing the amount of the decrease in tax if reconsideration of such other item is prevented by the operation of law. However, if the amounts of other items in the return are dependent upon the amount of adjusted gross income, taxable income, or net income, such as charitable contributions, foreign tax credit, depletion, and net operating losses, appropriate adjustment is to be made.

The Regulations state that section 1341 does not apply to legal fees or other expenses incurred in contesting the restoration of an item previously included in income. Such expenses are deductible only in the year paid or accrued.³³

Review of Example Giving Effect to Statutes

Let us review our original example, giving consideration to both the cases and the remedial statutes. Before the appointment

of the receiver, the Careless Oil Company and Mr. Farmer would report the income received under the claim of right and take the applicable deductions. From the time of the appointment of the receiver until the termination of the controversy, neither Mr. Owner, Mr. Farmer, nor the Careless Oil Company received any income or paid any expenses, nor were there sufficient ascertainable facts in that period to permit an accrual of either income or deductions. So, none of the parties would report any income or claim any deductions for that period.

The remedial statutes do, however, have a substantial effect on the tax computations for the year in which the receivership is terminated and funds paid over. For the purpose of this application, we must assume that the year in which the controversy terminated ended after December 31, 1954.³⁴

Under the statutes the Careless Oil Company and Mr. Farmer are entitled to deduct currently the amounts which they repay to Mr. Owner. However, if a lesser tax would result from eliminating the income reported for the years in which it was received, the taxpayer so benefiting by the application of section 1341 would pay the lesser tax.

Section 1305 should apply to Mr. Owner, so that his tax for the year in which he received the money would be the lesser of the amounts computed by, first, reconstructing his income for prior years as if he had received the income and, second, considering all of the income to have been earned and expenses incurred in the year he received the funds. Although section 1305 only applies to damages "for breach of contract or breach of a fiduciary duty or relationship," it should be held that Careless Oil Company had a quasi-fiduciary duty to pay bonuses and royalties to the person actually entitled to them (Mr. Owner), or that Mr. Farmer (or the receiver) received such funds imposed with a constructive trust for the benefit of Mr. Owner, or that Careless Oil Company by taking oil from the property became liable therefor in quasi-contract, etc. Nevertheless, it is possible that the words above quoted would be construed narrowly, so that Mr. Owner would not have the possible benefit of a spread back.

Summary

Undoubtedly, the example used in this presentation is oversimplified. Most oil and gas transactions today are much more complicated, involving a number of parties and a variety of inter-

ests, such as oil payments, overriding royalties, etc. However, as to each taxpayer, the basic rules apply regardless of the complexity of the fact situation. These rules may be summarized briefly, as follows:

1. Income is taxed when received or accrued under a claim of right.
2. Income in escrow or held by a receiver is not taxable until released.
3. Refunds of income received under a claim of right will be treated as current deductions or spread back, whichever produces the lesser tax.
4. The recipient of an award for breach of contract treats the amount received as income in the year of receipt (or accrualability) or spreads the income back over the period in which it arose, whichever produces the lesser tax.
5. A taxpayer is allowed the deductions based upon the gross income he would have received if there had been no breach of contract. Thus, gross income and taxable income are reconstructed for the purpose of computing depletion and depreciation.

Conclusion

The claim of right doctrine is firmly established; but the remedial statutes have, to a substantial extent, alleviated the hardships caused by the inflexible application of the doctrine. The Commissioner followed the intent of Congress, as expressed in the Committee reports, when drafting the Regulations under section 1341. It is to be hoped that Regulations, when proposed under section 1305, will follow the Congressional intent as closely, and will not restrict the benefits of section 1305 to persons who were parties to formal contracts or the beneficiaries of customary fiduciary duties or relationships.

NOTES

1. Section 1305, Section 1341, Internal Revenue Code.
2. *Mertens Law of Federal Income Taxation*, section 12.103.
3. 98 F. 2d 93 (CA-2, 1938).
4. *Board v. Commissioner* 51 F. 2d 73 (CA-6, 1931), cert. den. 248 U. S. 658.
5. 286 U. S. 417 (1932).
6. 340 U. S. 590 (1951). The harsh result of this decision was one of the reasons for the enactment of section 1341. See Report of the Committee on Ways & Means, House of Representatives to accompany H. R. 8300, at page A 294.
7. "Income Received Under Claim of Right as Affected by Section 1341," Frank M. Cavanaugh, Prentice-Hall *Oil and Gas Taxes*, paragraph 4013. Also see articles cited therein at footnote 11.
8. Op. cit. note 2, sections 12.103 and 12.104.

Tax Accounting for Oil Income

9. This is the Treasury position, and it is supported by many decisions. However, some believe that *Lambert, et al v. Jefferson Lake Sulphur Co.*, 236 F. 2d 542 (CA-5, 1956), is authority for deducting lease bonus payments. Obviously, this subject is beyond the scope of this paper.

10. See the discussion of the tax treatment of income impounded or held in escrow in *Mertens Law of Federal Income Taxation*, section 12.105. The terms and circumstances of the escrow, the rights of the parties, and the conditions imposed on the release of the escrowed funds or property, of course, determine the answer in each case.

11. *North American Oil Consolidated v. Burnet*, 286 U. S. 417 (1932); *U. S. v. Lewis*, 340 U. S. 590 (1951).

12. *Maurice P. O'Meara*, 8 T. C. 622 (1947).

13. "Oil Income and Deductions During Periods of Dispute," Benjamin L. Bird, *Proceedings of the Fourth Annual Institute on Oil and Gas Law and Taxation*, Southwestern Legal Institute, at page 424 et seq.

14. *Trojan Oil Company*, 26 B. T. A. 659 (1932); *Barnhart-Morrow Consolidated*, 47 B. T. A. 590 (1942); *National Petroleum & Refining Co.* 28 B. T. A. 569 (1933). This last case also holds that depletion is computed under the law in effect when the income is received rather than the law in effect when the oil is produced. *Estate of S. W. Anthony*, 5 T. C. 752 (1945) *H. L. Brown*, 11 T. C. 744 (1948). In most of these cases the facts indicate that the Treasury allowed depletion in computing the deficiencies asserted, and the Court made no comment on such allowance. Apparently, it was the understanding of the Government that depletion was allowable under the circumstances of the cases.

15. But see *Crews v. Com'r.*, 89 F. 2d 412 (CA-10, 1937), where it was held that the successful litigant could not include the proceeds from production in his gross income unless they were received by him. In this complex fact situation, the escrow agent misappropriated a substantial portion of the income from the property which was never recovered by the taxpayer.

16. *Massey v. Com'r.*, 143 F. 2d 429 (CA-5, 1944).

17. 185 F. 2d 535 (CA-5, 1950) cert. den. 340 U. S. 951.

18. Note 16 *supra*.

19. *Estate of Thomas E. Arnett*, 31 T. C. 320.

20. *Burton-Sutton Oil Co. v. Com'r.*, 328 U. S. 25 (1946).

21. In a footnote to its opinion in the *Arnett* case (note 19 *supra*) the Tax Court states that the authority of the *Parr* case even as to its peculiar facts has been weakened by the language in the Senate Finance Committee Report accompanying H. R. 232 (which added section 1305 to the Internal Revenue Code). This Report, after noting the *Parr* case, states that by the amendment to the Code "it is intended to make it clear that for the purpose of computing . . . deductions for depletion . . . the award is to have the same character as the income which would have been received or accrued except for the breach of contract or duty." (Emphasis supplied by the Tax Court.)

22. *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359 (1931).

23. Section 1305 was added in 1957 by P. L. 85-165.

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24. Section 1341, originally added by H. R. 8300, the Internal Revenue Code of 1954, was subsequently amended in 1958 by P. L. 85-866.

25. Senate Report No. 836, Eighty-fifth Congress, First Session, Calendar No. 860, on H. R. 232, August 7, 1957, C. B. 1957-2, 1071.

26. I. R. C. Section 613.

27. Op. cit. note 2, section 12.016 (a).

28. Regulations 1.1341-1.

29. *Ruben Simon, et al*, 281 F. 2d 520 (CA-6, 1960).

30. Op. cit. note 7.

31. 344 U. S. 6 (1952).

32. Regulations 1.1341-1 (3) (c).

33. Regulations 1.1341-1 (4) (h). Cf. *Cotnam*, 263 F. 2d 119.

34. Section 1305 applies to taxable years ending after December 31, 1954, but only as to amounts received or accrued after such date as a result of awards made after that date. Section 1341 was effective as part of Internal Revenue Code of 1954.



J. Wesley Huss (r.), partner in charge of the San Francisco office, is pictured about to emplane for Bombay. He planned to surprise his counterpart in the Los Angeles office, Robert S. Warner, who was due to arrive in New Delhi shortly thereafter.

SyCip, Gorres, Velayo & Co. (SGV)

For some time, the distinguished accounting firm of SyCip, Gorres, Velayo & Co. has served practically all Lybrand clients with operations in the Philippines. The close relationship that has developed between that firm and the Lybrand Firm has just been formalized by agreement between the two firms. Under this agreement, SyCip, Gorres, Velayo & Co. are now representing Lybrand, Ross Bros. & Montgomery and Coopers & Lybrand in the Philippines.

The history of the firm of SyCip, Gorres, Velayo & Co. goes back to the early postwar time when, after three years with the U. S. Air Force, Washington SyCip returned to the Philippines and started a public accounting practice with a staff of one typist. Most of Manila was still in ruins in March 1946, only a year after liberation. The growth of the SyCip firm since that time has been fully as phenomenal as the recovery of the country.

Mr. SyCip, the managing partner, obtained his bachelor's and master's degrees at the University of Santo Tomas in the Philippines and did further graduate work at Columbia University where he was elected to Beta Gamma Sigma. He then worked in the accounting firm of Byrnes & Baker in New York City, one of whose founders, Thomas Byrnes, was formerly connected with Lybrand, Ross Bros. & Montgomery.



Mr. SyCip

Mr. SyCip became active in local professional affairs on his return to Manila, and in 1951 he was elected president of the Philippine Institute of Accountants. He was also the

first recipient of that organization's award as the "Outstanding Accountant in Public Accounting."

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Alfredo Velayo, the co-managing partner, joined SyCip in 1947. Both men had attended grade school, high school and college together. Mr. Velayo himself had served as president of the Philippine Institute in 1959. From 1954-1956 he was Chairman of the Board of Accountancy, a position he was appointed to by President Magsaysay. In 1954, in recognition of his excellent services to the profession, he was cited as "Outstanding Accountant in Public Accounting" by the Philippine Institute.

While the growth of the SGV firm has been mainly through its own expansion, there were two events which accelerated its progress. On May 1, 1953 the firm merged its practice with that of Henry Hunter Bayne & Co., which had started as a firm of Chartered Accountants in 1906. With this merger, Ramon J. Gorres joined the firm and the name of SyCip, Gorres, Velayo & Co. was adopted. At this point the firm was made up of five partners and 61 staff members.

In June 1958 SGV assumed the practice of Fleming & Williamson, a firm which had been in existence in the Philippines since 1902 and whose British partners had decided to retire from public accounting. By this time the size of the firm had grown to 241; and by the end of 1960 there were 360 people in the organization. Today it is the largest professional accounting firm in the Far East.

The service divisions of the firm include auditing, taxes, and management services. The firm undertakes engagements throughout the Philippines and in such neighboring areas as Okinawa, Guam, Indonesia, and Vietnam. The clients of SGV include firms and establishments in every major line of business in the Philippines, including banks and financial institutions, insurance companies, oil companies, manufacturing and trading concerns, mining, transportation, shipping and communication companies, hospitals, educational institutions, construction and real estate companies.



Mr. Velayo

SyCip, Gorres, Velayo & Co. (SGV)



Mr. Gorres

Another interesting phase of SGV's clientele is that they comprise such varied nationalities—Filipino, American, British, Chinese, Swiss, Swedish, Spanish, German, French, Indian and Japanese.

The rapid growth of the firm can be partly attributed to its emphasis on the development of staff at all levels. Aside from junior and senior staff training programs, the firm continually sends senior and supervisory staff to the United States for graduate schooling and experience. The firm also

has sent its partners to various advanced management programs in the United States to enable the partners to provide better advice to clients in all phases of their activities.

In its desire to contribute towards elevating accounting standards in the country and to help deserving young students, the firm has standing yearly scholarships in accounting at two leading universities in Manila. The firm also has published *Standard Audit Working Papers*, a book which is currently being used in the leading universities offering advanced auditing courses.

The present partners and principal of the firm are:

WASHINGTON SYCIP, Managing Partner and Chairman of Executive Committee; ALFREDO M. VELAYO, Co-managing Partner and member of Executive Committee; RAMON GORRES, Partner—Audit, and member of Executive Committee; RODOLFO JACOB, Partner—Audit; ARTURO MONZON, Principal in charge of Tax Division; ARSENIO MARALIT, Partner—Audit; JOSE QUINTOS, Partner in charge of Branch Offices; ARTEMIO RAYMUNDO, Partner in charge of Management Services Division; EDUARDO VILLANUEVA, Partner—Audit; EUGENIO REYES, Partner—Audit; CASIMIRO OCAMPO, Partner—Audit; GABRIEL PIMENTEL, Partner—Audit; VICENTE JOSE, Partner—Tax.



SGV BUILDING—MANILA



In 1955 the SGV Firm constructed its own four-story building, the "SGV Building," to house the rapidly expanding organization. The Firm also has opened branch offices in Cebu, Bacolod and Davao. Also shown are the Firm's lounge (u.l.), conference room (u.r.), library (b.l.) and report department (b.r.).



Roberto Casas Alatrisme —

A Half Century of Practice

*La diligencia es madre de la buena ventura y la pereza, su contrario, jamás llegó al término que pide un buen deseo.—Don Quixote**

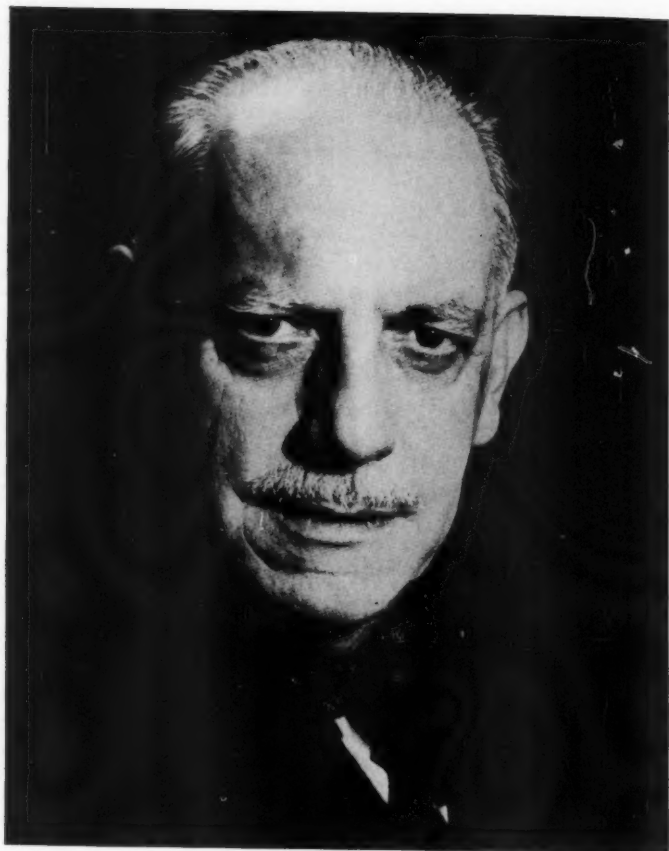
Coopers and Lybrand announced with pride in 1957 that the distinguished firm of Despacho Casas Alatrisme of Mexico City had joined the newly formed international organization. With equal pride, Coopers & Lybrand joins his many fellow-countrymen in saluting the senior partner of that firm on the celebration of his fiftieth year as an active practitioner and leader of the Mexican profession.

In 1910, Roberto Casas Alatrisme passed his professional examination and entered the practice of accountancy. A half-century later the flood of congratulatory messages from all over the world, as well as the local celebrations, attest to a truly remarkable professional career of one of the pioneers of the profession in his country. On August 20, 1960, fifty years to the day of passing his examination, a Thanksgiving Mass was sponsored by his immediate family. That evening, his firm gave a dinner at the Hotel El Presidente for more than 250 guests. Included among the distinguished guests paying tribute to Roberto Casas Alatrisme were two retired college professors who instructed him during his student days, and Mr. Alvin R. Jennings, Managing Partner of L. R. B. & M., who made a special trip to Mexico to attend this event.

Further commemoration of Don Roberto's golden anniversary took place at the Hotel Del Prado, when the two foremost accounting organizations in Mexico, the Mexican Institute of Public Accountants and the Association of Public Accountants of Mexico City, met to honor him.

Roberto Casas Alatrisme was born in Teziutlán, Puebla, Mexico on August 5, 1892 and studied Commerce at the Escuela Superior de Comercio. His public service preceded his professional service with his election to Congress in 1918. During three consecutive

*Diligence is the mother of good fortune, and idleness, its opposite, never brought a man to the goal of any of his best wishes.



ROBERTO CASAS ALATRISTE

two-year terms in Congress he represented the States of Sinaloa, Puebla and Distrito Federal. During his membership in Congress, he served on the Commissions of Public Credit, Budget and Treasury Accounting. He also took part in the joint commissions discussing the Lamont-de la Huerta agreement in regard to the Mexican public debt.

Don Roberto was a founder of the Mexican Institute of Public Accountants, "Colegio de Contadores Públicos," and has served on that organization's council, many of its committees, and was President in 1933 and 1947.

For more than thirty years he has taught a number of subjects in the two principal commerce schools in Mexico City. He acted as secretary at the Escuela Superior de Comercio in 1915 and was Dean of the National School of Commerce of the National University in 1933.

In addition to being a professor and dean of the School of Commerce, he has served as a member of the "Patronato" of the University (a board of three members mainly in charge of the preparation and supervision of the budget), and is now a member of the Board of Governors, the highest authority in the University.

Don Roberto's activities have not, however, been confined to his native country alone. Since 1924, Señor Casas Alatríste has attended almost every annual meeting of the American Institute of CPAs, of which he is an international associate. He has headed the Mexican delegations to International Accounting Congresses in New York, London and Amsterdam, as well as the Inter-American conferences on accounting in Puerto Rico, Mexico, São Paulo and Chile. In the second Inter-American Conference on Accounting, in 1951, he was designated "Contador Emérito de América" (Accountant Emeritus of America).

On a number of occasions he has functioned simultaneously in a public and professional capacity. He was a member of a committee in charge of the liquidation of several banks of issue in Mexico when, at the depths of the depression, the Central Bank (Banco de México) was organized.

He has served as external auditor for Banco de México from 1933 to the present. He presided over a commission making an economic study of the national railroads in 1949. After the Second World War, he was appointed advisor to the Mexican delegation of the Second Conference of UNESCO. And, in 1947, he represented Mexico in the audit committee of the International Monetary Fund.

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In 1934 Señor Casas Alatríste started publishing a technical monthly magazine *Finanzas y Contabilidad* (Finance and Accounting) which is now the oldest technical magazine on accounting in Mexico. He has also been in charge of the translation into Spanish of the complete accounting course of Northwestern University and of the CPA Manual of W. A. Paton.

In 1919 he married Adolfiná Hernández Carsi, and is the father of five children.

In announcing the joining of the Alatríste Firm with the international firm of Coopers & Lybrand three years ago, the LYBRAND JOURNAL stated that the history of his firm and the history of the accounting profession in Mexico has paralleled the career of Roberto Casas Alatríste. The celebration last fall would seem to have put the entire Mexican profession's formal stamp of approval on this observation.

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Recent Library Acquisitions

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- Wilson, H. A. R. J. Spicer & Pegler's income tax and profits tax, 24th edition. H. F. L. (Publishers) Ltd., London. 1961.
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Speaking Engagements

<i>Date</i>	<i>Speaker</i>	<i>Organization</i>	<i>Topic</i>
Oct.			
4	Albert P. Teetzel, Detroit	Annual Midwest Regional Meeting, Steel Service Center Institute	Be Tax Wise on Expenses
5	Roy H. Webster,	Northwest Tax Conference,	Group Discussion Leader
7	Portland	Gearhart, Oregon	
7	Frank P. Smith, New York	10th Annual Meeting, Middle At- lantic Association of College of Business Administration at Rut- gers State University	Panel Discussion—Standards of Education and Experience for CPAs
10	Andrew S. Sapega,	Systems & Procedures Association,	Seminar Chairman — Feasibility
12	New York	International Systems Meeting	Studies for Large Scale Com- puters
10	Richard W. Russell, Los Angeles	University of Southern California	Experiences in Accounting
10	Michael Shegda, New York	Middle Management Program, New York University	Budgeting
11	Mark E. Richardson, New York	2nd Annual Atlantic Coast Re- gional Meeting, Steel Service Center Institute, Lake Placid, New York	Be Tax Wise on Expenses
13	James E. Gelbert, Pittsburgh	West Virginia Tax Institute, West Virginia University	Current Events
14	Philip L. Deffiese, New York	Kentucky Society of CPAs, Institute on Accounting	Sub-Standard Audit Reports
14	Bill Goodner, Birmingham	Southern Chapter, Steel Service Center Institute	Proper Ways of Handling Expense Account Information
17	Andrew S. Sapega, New York	N.A.A., Mid-Hudson Chapter, Poughkeepsie	EDP Feasibility Studies for Large Scale Computers
17	Joseph E. Tansill, Chicago	Tax Seminar, University of Toledo	1960 Aspects of Travel and Entertainment Expenses
17	G. W. Welsch, Dallas	Eighth Annual Texas Tech Tax Institute, Lubbock	Current Developments in Federal Income Taxation
18	John J. McCullough, Detroit	Pennsylvania State University	European Common Stock
18	William W. Ragsdale, Birmingham	N.A.A., Birmingham Chapter	Current Accounting Developments
18	M. E. Richardson, New York	North Carolina Association of CPAs, 21st Annual Accounting and Taxation Symposium	Expense Deduction Requirements
18	Joseph E. Tansill, Chicago	N.A.A., South Bend Chapter	Recent Developments in Taxation
19	Leo V. Tinkham, Chicago	Illinois Society of CPAs, Central Chapter, Decatur	Improved Observance of Report- ing of Standards
20	Michael Shegda, New York	Lake Superior Industrial Engi- neering Society, Duluth	EDP—When?
21	Philip L. Deffiese, New York	The Michigan Association of CPAs, Detroit	The Auditor's Problems With Special Reports
24	Herbert G. Bowles, Los Angeles	California Society of CPAs, Los Angeles Chapter	Alternatives Among Generally Ac- cepted Principles of Accounting
24	J. Wesley Huss, San Francisco	Controllers Institute of America, Mining and Extractive Industry Round Table	Earlier Release of Consolidated Earnings Figures—What Can Be Done to Accelerate the Public Accountant's Certificate

Speaking Engagements

<i>Date</i>	<i>Speaker</i>	<i>Organization</i>	<i>Topic</i>
Oct.			
24	Howard L. Swiger, Rockford	N.A.A., Rockford Chapter	Company Uses of Direct Cost
25	Alvin H. Carley, Boston	Small Business Clinic, Pittsfield, Massachusetts	What to Expect From Your Records
25	Herman C. Heiser, New York	Federal Government Accountants Association, Boston	Electronic Data Processing
25	Paul S. Lovoi, Tulsa	N.A.A., Tulsa Chapter	Discussion Leader—Managing a CPA Firm
25	Herman Stuetzer, Jr., Boston	Treasurer's Club of Greater Boston	How Leasing Affects the Balance Sheet
26	Stanley N. Roseberry, Hartford	N.A.A., Hartford Chapter	Discussion Leader—Inventory Evaluation
26	Andrew S. Sapega, New York	Office Executives Association, National Business Show	Chairman, Technical Sessions
27	Maurice B. T. Davies, Los Angeles	California Society of CPAs, Los Angeles Chapter, Fourth An- nual Accounting Systems Con- ference	Types of Accounting Systems Problems and How to Recognize Them
27	Joseph E. Tansill, Chicago	University of Chicago	Changes in Accounting Methods
27	G. W. Welsch, Dallas	Tenth Annual Tulane Tax Institute, New Orleans	Tax Accounting for Oil and Gas Income and Deductions During Periods of Litigation and Dispute
28	Michael Shegda, New York	York Division, Borg-Warner Cor- poration, York, Pennsylvania	Problems in Electronic Data Processing
31	Herman Stuetzer, Jr., Boston	Boston Tax Forum	How Leasing Affects the Balance Sheet
Nov.			
2	Charles R. McCready, Boston	Massachusetts Society of CPAs	Panel Discussion—Financing Methods
3	Frank P. Smith, New York	Beta Alpha Psi Meeting, Lehigh University	Training Programs for Public Accounting
3	John J. O'Donnell, Detroit	Third Annual National Conference and Technical Exhibit, Ameri- can Production & Inventory Control Society	Inventory Control Methods Which Eliminate Annual Inventories and Duplicate Records
4	M. E. Richardson, New York	Arizona Society of CPAs, Annual Meeting, Tucson	Federal Tax Requirements—Offi- cers' and Employees' Expenses
6	Raymond E. Graichen, Philadelphia	Wayne Presbyterian Church, Wayne, Pa.	Church Accounting
7	Jerome Halperin, Detroit	Michigan Association of CPAs	Settlement Procedures Relating to Michigan Taxes
9	William J. Holland, Philadelphia	Loyola College, Baltimore	Management Services Opportuni- ties in Public Accounting
9	George H. Kern, Chicago	Iowa Control of Controllers' In- stitute of America, Marshalltown	Current Developments in Tax Savings
9	Roderick K. Macleod, Boston	Massachusetts Society of CPAs	Discussion Leader—Internal Control
9	H. O. Reyburn, Tulsa	Oklahoma Society of CPAs, Tulsa Chapter	Rule 13 as Discussed at American Institute of CPAs
10	Lewis A. G. Martorano, Philadelphia	N.A.A., Philadelphia Chapter	Acceptance of Direct Costing

LYBRAND JOURNAL

<i>Date</i>	<i>Speaker</i>	<i>Organization</i>	<i>Topic</i>
Nov.			
10	Kenneth J. Mutzel, Philadelphia	19th Annual Federal Tax Institute, New York University	Panel Discussion — Permissible Differences Between Book and Tax Accounting
10	Frank P. Smith, New York	Pennsylvania Institute of CPAs, Pittsburgh Chapter	Evolution of Practice and Training in Public Accounting
10	G. W. Welsch, Dallas	Midland Estate Council, Midland, Texas	Tax Aspects of Pension and Profit Sharing Plans
14	Philip L. Defiese, New York	Massachusetts Society of CPAs, Springfield	Sub-Standard Audit Reports
14	J. Paul Finnegan, Boston	N.Y.U. on Federal Taxation, New York	Panel Discussion—Employees' Expenses
14	Kenneth P. Johnson, Pittsburgh	N.A.A., Pittsburgh Chapter	Discussion Chairman—Justifying Capital Expenditures
15	Tibor Fabian, New York	N.A.A., Long Island Chapter, Garden City	OR and the Accountant
15	Jerome Halperin, Detroit	Cleary College and Small Business Administration	Taxation for Small Business
15	Sidney Kess, New York	New York State Society of CPAs	Panel Discussion—Analysis of an Estate Plan
15	Burton E. Lindgren, Rockford	N.A.A., Rockford Chapter, Workshop Seminar	Tax Considerations in Management Decisions
15	Paul D. Yager, Los Angeles	Steel Service Center Institute, Pacific Coast Regional Annual Meeting, Pebble Beach	Be Tax Wise on Expenses
15	Harry C. Zug, Philadelphia	Pennsylvania Institute of CPAs, Philadelphia Chapter	Problems in Writing a Report
16	Raymond E. Graichen, Philadelphia	Drexel Institute of Technology, Freshman Class	Certified Public Accounting
17	William T. Barnes, Washington	Tenth Annual Tax Conference, Wichita, Kansas	The Accounting Methods Dilemma
17	Fred C. Dennis, Cincinnati	Ohio Society of CPAs, Annual Student Night	Public Accounting
17	Herbert G. Bowles, Milton J. Hoffman, Los Angeles	California Society of CPAs, Los Angeles Chapter, CPA-Bankers Seminar	Panel Discussion — Banker - Customer - Accountant Relationships
17	Henry B. Jordan, Washington	Steel Service Center Institute, Baltimore	Expense Account Problems
17	Sidney Kess, New York	Accounting Society of the City College of New York	Self-Preparation for the CPA Examination
17	Harry J. Spellman, Philadelphia	Palmyra-Riverton Rotary Club, Riverton, New Jersey	Individual Taxes
17	J. Walker Voris, Los Angeles	The Institute of Internal Auditors, Los Angeles Chapter	Organizing for Greater Efficiency
17	G. W. Welsch, Dallas	Tyler Estate Council, Tyler, Texas	The Role of the Accountant in the Administration of an Estate
18	Philip L. Defiese, New York	South Carolina Association of CPAs, Mid-Year Meeting, Columbia	Sub-Standard Reports
18	Herman C. Heiser, New York	Puerto Rico Institute of CPAs, San Juan	The Role of the CPA as a Management Consultant
18	G. W. Welsch, Dallas	Regional Meeting of Accounting and Finance Council of American Trucking Associations, Inc.	Depreciation and Taxes

Speaking Engagements

<i>Date</i>	<i>Speaker</i>	<i>Organization</i>	<i>Topic</i>
Nov.			
19	Henry B. Jordan, Washington	University of Scranton Tax Institute	You Can Help to Write Our Tax Laws
21	Joseph W. Bower, Pittsburgh	N.A.A., Pittsburgh Chapter	Discussion Leader—Planning and Controlling the Cash Flow
22	J. Wesley Huss, Calvin H. Nelson, Donald W. Schroeder, San Francisco	The California Society of CPAs, San Francisco Chapter, RMA- CPA Joint Meeting	Panel Discussion—Changing Con- cepts Relating to the Presenta- tion of Long-Term Leases in the Financial Statements
22	William H. Lundquist, Philadelphia	N.A.A., North Pennsylvania Chapter, Norristown	Overhead: Cost Volume Relationships
22	James Neely, Jr., Boston	Bentley School of Accounting & Finance	Your Career in Systems and Procedures
28	Andrew S. Sapega, New York	Controller's Institute	EDP Feasibility Studies
29	Joseph E. Tansill, Chicago	Estate Planning Council, Hammond, Indiana	Short Term Trusts
30	Claude R. Giles, San Francisco	The California Society of CPAs, San Francisco Chapter	Professional Conduct
30	Raymond E. Graichen, Philadelphia	Federal Tax Forum, Lehigh University, Bethlehem	Buying and Selling a Business
30	Joseph J. Hyde, San Francisco	Estate Planning Council of Bakersfield	The CPAs Role in Estate Planning
30	William W. Ragsdale, Jr., Birmingham	University of Alabama	Panel Discussion—Overhead Classification, Allocation and Distribution
Dec.			
1	James E. Meredith, Jr., Philadelphia	N.A.A., Pittsburgh Chapter, Con- ference on Direct Costing	Fundamentals of Direct Costing
1	Joseph E. Tansill, Chicago	Illinois Society of CPAs	Seminar Leader—Taxation
1 & 8	Tibor Fabian, New York	Wharton School of Finance, Philadelphia	Marketing and OR
1	Hubert Brink, Jr., Philadelphia	Industrial Nucleonics Corporation, Divisional Sales Meeting, St. Davids, Pennsylvania	Accounting and Taxes
1	William G. Casey, Boston	Controller's Group, Providence	Direct Costing
2	Richard T. Farrand, Philadelphia	Philadelphia Institute of CPAs, Tax Forum	Purchase of a Business
2	Jerome Halperin, Detroit	Michigan Association of CPAs	Tax Problems in Acquiring Real Estate
3	M. E. Richardson, New York	New York University, School of Commerce, Accounting Seminar	Ethical Responsibilities in Tax Practice
6	William W. Ragsdale, Jr., Birmingham	University of Mississippi	Careers in Public Accounting
7	Philip J. Taylor, Philadelphia	LaSalle College	Public Accounting as a Career
8	Joseph E. Tansill, Chicago	Indiana Society of CPAs	1960 Aspects of Travel and Entertainment
9	Paul D. Yager, Los Angeles	Oregon Society of CPAs, 11th Annual Tax Forum	The Case of the Misguided Subchapter S
10	Kenneth J. Mutzel, Philadelphia	Stradley Tax Luncheon	Permissible Differences Between Book and Tax Accounting

LYBRAND JOURNAL

<i>Date</i>	<i>Speaker</i>	<i>Organization</i>	<i>Topic</i>
Dec.			
10	H. O. Reyburn, Tulsa	Oklahoma Bankers Conference	Income Taxes
12	Joseph E. Tansill, Chicago	N.A.A., Racine-Kenosha Chapter	Year-End Tax Planning for Individuals
13	James E. Meredith, Jr., Philadelphia	N.A.A., Trenton Chapter	Standard Direct Costing—A Suc- cessful Management Technique
13	Andrew S. Sapega, New York	New York Savings Bank	What is EDP?
13	Joseph E. Tansill, Chicago	Lyons Club of Maywood, Illinois	What To Do When the Revenue Agent Calls
14	J. Wesley Huss, San Francisco	The California Society of CPAs, Bakersfield Chapter	Our California Legislative Program
14	Joseph E. Tansill, Chicago	Annual Federal Income Tax In- stitute, Northern Illinois University	1960 Aspects of Travel and Entertainment
15	James E. Meredith, Jr., Philadelphia	The First Pennsylvania Banking and Trust Company	Management of a Business
15	Herman Stuetzer, Jr., Boston	N.A.A., Merrimack Valley Chapter, Andover	State Taxes
15	G. W. Welsch, Dallas	Petroleum Accountants Society of Dallas	Tax Accounting for Oil Income and Deductions during Periods of Litigation and Dispute
19	Norman E. Auerbach, New York	New York State Society of CPAs, Joint Meeting Federal Taxation Committee and Real Estate Accounting Committee	Panel Discussion—Associations Taxable as Corporations
19	Jerome Halperin, Detroit	Small Business Administration	Taxation for Small Business
20	Tibor Fabian, New York	A.M.A.	Equipment Replacement and Maintenance Problems Solved With OR
20	Joseph J. Hyde, San Francisco	N.A.A., San Francisco Chapter	Do It Now—Year-End Tax Planning
20	G. W. Welsch, Dallas	Texas Society of CPAs, Dallas Chapter	Recent Development in Federal Income Taxation
29	James E. Meredith, Jr., Philadelphia	Trust Department, First Pennsyl- vania Banking and Trust Company	Management Services by CPAs

Professional Society Assignments

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

The following partners and members of our staff are serving as members of council or on committees for the year 1960-61:

Members of Council

Elected Members

Mark E. Richardson	New York
Claude R. Giles	San Francisco
Mark C. Walker	Boston
Harry C. Zug	Philadelphia
Milton J. Hoffman	Los Angeles

Member at Large

George A. Hewitt	Philadelphia
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Ex-Officio—Past President

Alvin R. Jennings	New York
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Trial Board

George A. Hewitt	Philadelphia
David H. Brodie	San Francisco

Committees

Outside the Normal Committee Structure

Accounting Principles Board	Alvin R. Jennings, New York
International Congress Planning Committee	R. Kirk Batzer, New York
Relations with the Bar	John C. Potter, Detroit

Committees

Advisory Committee on Professional Development	{ Philip J. Taylor, Philadelphia Carl D. Tisor, Phoenix
Auditing Procedure (Chairman)	
Coordination of Tax Activities	
Estate Planning	Norman E. Auerbach, New York
Ethics of Tax Practice	J. Paul Finnegan, Boston
Long-Range Tax Policy	Mark E. Richardson, New York
Federal Taxation	
Partnerships and Partners	Philip Bardes, New York
Special Tax Problems	Herman Stuetzer, Jr., Boston
Administration, Procedure and Miscellaneous Taxes	Paul D. Yager, Los Angeles
Management of an Accounting Practice	Calvin H. Nelson, San Francisco
Professional Statistics	Harry W. Verhoef, Seattle

LYBRAND JOURNAL

Membership Relations

Awards	Coleburke Lyons, Detroit
Insurance Trust (Chairman)	Alvin R. Jennings, New York
Meetings	Leo V. Tinkham, Chicago
Membership Policy	Robert L. Starks, Cleveland
Staff Accountants	Alfred J. Krupka, New York

Professional Ethics	{ James E. Hammond, San Francisco
	{ Carl D. Tisor, Phoenix

Relations with Government Agencies

Accounting for Public Housing	Harold C. Chinlund, Baltimore
Civil Aeronautics Board	R. Kirk Batzer, New York
Interstate Commerce Commission	G. F. Schweitzer, Philadelphia
Labor Union and Welfare Funds	Price G. Righter, Philadelphia
National Defense	William T. Barnes, Washington
Public Utilities (Chairman)	Walter R. Staub, New York

Relations with Other Groups

International Relations	James J. Mahon, New York
Public Affairs	Harry C. Zug, Philadelphia
Personnel Recruiting	Leonard L. Hopkins, Columbus
Trade Associations (Chairman)	J. Wesley Huss, San Francisco

Specialized Accounting

Uniform Accounting Provisions of State Corporation Laws	Carl Simon, New York
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Specialized Audits (Chairman) Philip L. DeFiese, New York

Accounting and Auditing with Electronic Computers	Herman C. Heiser, New York
Bank Auditing	{ Donald J. Atwater, San Francisco
	{ J. Edward Burke, New York
Relations with Surety Companies	Louis C. Moscarello, New York
Securities Brokers and Dealers (Chairman)	George E. Doty, New York
Statistical Sampling (Chairman)	Thomas J. Cogan, New York

Committees on Membership

California	Calvin H. Nelson, San Francisco
Illinois	Lawrence Frazee, Rockford
Massachusetts	Vincent R. Collins, Boston
Ohio	Katherine E. Pfeifer, Cleveland

Notes

BIRMINGHAM

Mr. Fred Browning passed the CPA examination.

Mr. Woodrow W. Pitzer received an Alabama reciprocal certificate.

BOSTON

Mr. J. Paul Finnegan attended the President's Conference on Aging in Washington, D. C. as a delegate from Massachusetts.

Mr. Joseph B. Fyffe has resigned as a Manager after twenty-six years' service to establish his own accounting practice.

At the annual Quarter Century Club luncheon Miss Laura M. Marshall was presented with a gold watch in recognition of more than forty-two years of service with our office. Miss Marshall retired early this year.

Mr. Mark C. Walker was elected President of the Newton-Wellesley Hospital.

Messrs. Donald A. Day and Vincent F. Raso have become fellow members of the Massachusetts Society of CPAs and Mr. William C. Greene has become an associate member of this Society. Mr. Day has also become a member of the American Institute of CPAs.

Mr. William G. Casey, who holds a Pennsylvania CPA certificate, has received his Massachusetts certificate by reciprocity.

We report with deep regret the deaths of the following retired staff members during the past year: Mr. Charles F. Brooks, Mr. Yves H. Buhler and Mr. Leopold Koallick.

CHICAGO

Mr. Leo V. Tinkham will be Chairman of the Illinois State Chamber of Commerce's subcommittee on Technical Problems of the Federal Taxation Committee.

Mr. Glenn E. Wabel is a member of the Special Gifts Committee for Provident Hospital.

The following have passed the CPA examination in Indiana:

Frederick C. Mischke

William R. Parient

CINCINNATI

Mr. Robert W. Davis is a member of the Finance Commission of the Hyde Park-Community Methodist Church.

LYBRAND JOURNAL

Mr. Willis K. Waterfield has been elected for a three-year term as a member of the Board of Trustees of The Cincinnati Club. He will also serve as Advisory Chairman of this year's "Every Member Canvass" at the Mt. Washington Presbyterian Church.

The following members of the Cincinnati staff have successfully passed the CPA examination:

Joseph L. Deidesheimer

Ronald F. Henke

DALLAS

Mr. Kenneth Arthur has been elected Treasurer of the Brook Hollow Golf Club. He will again be a Team Captain for the Park Cities Y.M.C.A. fund drive.

Mr. Godfrey W. Welsch is a member of the Tax Study Committee for the Independent Petroleum Association of America.

DETROIT

Mr. Coleburke Lyons is currently President of the United States Men's Curling Association.

Mr. John J. O'Donnell, Jr. is a member of the American Production and Inventory Control Society.

The following members of the Detroit Office have successfully completed the Certificate of Examination requirements:

Geraldine F. Dominiak

Joseph S. Kutas

Norman Griffin

Elwin C. Meyers

James M. Guertin

Herbert Miller

John Wicks

HARTFORD

Mr. Robert J. Smith has passed the CPA examination.

HOUSTON

We report with deep regret the death of Mrs. Daisy B. Wimer.

LOS ANGELES

Mr. Herbert G. Bowles will serve this year as a member of the CPAs Administrative Committee for the State Board of Accountancy.

Mr. Milton J. Hoffman presented the Lybrand-University of Southern California scholarship for 1960-61 to Darrell Burrage at an Awards Dinner on the university campus.

Mr. James M. Nicolai has been elected Treasurer of the Los Angeles Junior Chamber of Commerce.

Mrs. Eva R. Orloff has retired after twenty-eight years of service in the Los Angeles office. She was honored on the eve of her retirement at a dinner attended by her many friends.

Mr. David V. Burgett received his CPA Certificate for California, and the following have passed the CPA examination:

John H. Crawford

Kenneth V. Domingues

Marcus S. Labe

LOUISVILLE

Mr. Curtis J. French presented the inter-chapter competition trophy to the Cincinnati Chapter of the N.A.A. at their October meeting.

Mr. Raymond C. Broderick has passed the CPA examination.

NEW YORK

Mr. Philip Bardes is currently serving as a member of the Taxation Committee of the National Association of Manufacturers.

Dr. Tibor Fabian has been elected Associate Secretary of the Institute of Management Sciences (TIMS) for 1961. This is a three years' tour of duty, the title becoming progressively Secretary-Treasurer and Vice Chairman of the Council in successive years.

Mr. Mark E. Richardson is serving as a member of the Advisory Council of the Tax Institute, Inc. for a two-year period. He is currently a member of the Board of Trustees of the Alumni Fund of Girard College and continues his work with the New York Chamber of Commerce as a member of a special committee on membership.

Mr. Robert J. Schoen has been appointed Chairman of the 1961 Combined Health Appeal of Chatham, N. J.

PHILADELPHIA

Mr. Raymond E. Graichen will serve as a member of the Advisory Committee to help plan and promote the first annual tax conference to be held at the Wharton School of Finance and Commerce, University of Pennsylvania.

Mr. John L. Moneta is the Chairman of the CPAs group for the 1961 Easter Seal Campaign. He also served on the Nominating Committee for the Better Business Bureau.

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LYBRAND JOURNAL

Mr. Gustave F. Schweitzer is in charge of the Accountants' Division of the Philadelphia Fellowship Commission for the 1961 Membership Enrollment.

Mr. George L. Simmon has been elected Treasurer of The Valley Forge Church in King of Prussia.

Mr. Harry C. Zug has been re-elected for the third consecutive year as Treasurer of The Merion Cricket Club. He is also serving on two Gift Committees—the Harvard Business School Alumni Club of Philadelphia, and the Republican Finance Committee of Pennsylvania.

PITTSBURGH

Mr. Joseph W. Bower was elected Chairman of the Pittsburgh Business Show Committee. He was recently given honorary membership in Beta Alpha Psi Fraternity, conferred by the Alpha Tau Chapter at the University of Pittsburgh.

ROCKFORD

Mr. Lawrence E. Frazee is one of the Directors of the Rockford Chamber of Commerce. As in the past, members of the Rockford Office are active members of various committees.

Consumers' Protection	Edward J. Rudnicki
Finance	Robert W. Myers
National Affairs	Robert W. Myers
Taxation	Lawrence E. Frazee
	Francis A. Gallagher
	Burton E. Lindgren
Social Security and Unemployment Compensation	J. Warren Rowland

Mr. J. Warren Rowland has been elected Treasurer of the Annual Pancake Day of the Kiwanis Club of Rockford.

The following members of the Rockford Office have successfully passed the CPA examination:

Glen R. Cole	Dwain K. Tanke
Harley M. Courtney	Gerald B. Williams
John E. Young	

SAN FRANCISCO

Mr. David H. Brodie is the 1961 Chairman of the Membership Campaign for the Central Branch of the Y.M.C.A.

The Confrerie De La Chaine Des Rotisseurs (International Gourmet Society) has named Mr. Michael P. Ferro "Chevalier" (an amateur chef possessing spit) for a term described as "depending on his stomach."

Mr. James E. Hammond will be Chairman of the Development Committee for the Board of Trustees, Golden Gate College this year.

Mr. J. Wesley Huss has been reappointed as a member of two committees—the House Committee of the St. Francis Yacht Club, and of the Tax Section of the San Francisco Chamber of Commerce.

Mr. James L. Johnson will serve on the Audit Committee of the Exchange Club of San Francisco. He is also a member of the Finance Committee of the Los Altos Country Club.

Mr. Calvin H. Nelson is a member of the Budget Study Committee of the United Bay Area Crusade.

Messrs. Richard V. Smith and David E. Russell have passed their California Bar examinations.

Messrs. John T. Belshaw and Thomas T. Giles have been admitted to membership in the American Institute of CPAs.

Messrs. Morgan Benezra, Thomas T. Giles and Edward N. Torme, Jr. have received their CPA certificates.

SEATTLE

Mr. Russel A. Pearson will be active in the Methodist Educational Foundation, holding the office of Secretary and serving as a member of the Executive Committee and of the Board of Trustees. He is Commissioner of the Seattle Transit Commission for the period 1961 through 1965. Mr. Pearson also holds a two-year position as a member of the Board of Trustees of the King County Anti-Tuberculosis League.

Mr. Harry W. Verhoef is Treasurer and a member of the Board of Directors for 1961 of the Olympian Tuxedo Club.

TULSA

Mr. R. E. Howard has passed the CPA examination.

Meritorious Service Award
to
Lybrand, Ross Bros. & Montgomery

for the valuable auditing services it has generously contributed
since the beginning of the Foundation's fight against arthritis
and other crippling rheumatic diseases.

Floyd B. Odum
Floyd B. Odum
Chairman of the Board



General George C. Kenney
General George C. Kenney
President

The Arthritis and Rheumatism Foundation

October 27, 1960

*The above plaque was presented to the Firm for its role in
the campaign of The Arthritis and Rheumatism Foundation*



